

LLOYDS TSB GROUP PLC  
Form 20-F  
June 06, 2006

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As filed with the Securities and Exchange Commission on 6 June 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 20-F**

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
OR  
 ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended 31 December 2005  
OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
OR  
 SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-15246

**LLOYDS TSB GROUP plc**

(Exact name of Registrant as Specified in Its Charter)

**Scotland**

(Jurisdiction of Incorporation or Organization)

**25 Gresham Street  
London EC2V 7HN  
United Kingdom**

(Address of Principal Executive Offices)

**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

**Title of each class**

**Name of each exchange on which registered**

Ordinary shares of nominal value 25 pence each, represented  
by American Depositary Shares.

The New York Stock Exchange.

**Securities registered or to be registered pursuant to Section 12(g) of the Act:**

None

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:**

None

The number of outstanding shares of each of Lloyds TSB Group plc's classes of capital or common stock as of 31 December 2005 was:

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Ordinary shares, nominal value 25 pence each, as of 31 December 2005...5,602,613,600

Limited voting shares, nominal value 25 pence each, as of 31 December 2005... 78,947,368

Preference shares, nominal value 25 pence each, as of 31 December 2005... 400

Preference shares, nominal value 25 cents each, as of 31 December 2005..... 0

Preference shares, nominal value 25 euro cents each, as of 31 December 2005..... 0

Preference shares, nominal value Japanese ¥25 each, as of 31 December 2005... 0

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Yes  No

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-Accelerated filer   
Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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**PRESENTATION OF INFORMATION**

In this annual report, references to Lloyds TSB Group are to Lloyds TSB Group plc and its subsidiary and associated undertakings; references to Lloyds TSB Bank are to Lloyds TSB Bank plc; and references to the Consolidated Financial Statements or financial statements are to Lloyds TSB Group's Consolidated Financial Statements included in this annual report. References to the Financial Services Authority are to the United Kingdom (the UK) Financial Services Authority.

Lloyds TSB Group publishes its Consolidated Financial Statements expressed in British pounds ( pounds sterling , sterling or £ ), the lawful currency of the UK. In this annual report, references to pence and p are to one-hundredth of one pound sterling; references to US dollars , US\$ , \$ are to the lawful currency of the United States (the US ); references to cent are to one-hundredth of one US dollar; references to euro or the lawful currency of the member states of the European Union that have adopted a single currency in accordance with the Treaty establishing the European Communities, as amended by the Treaty of European Union; and references to Japanese yen Japanese ¥ or ¥ are to the lawful currency of Japan. Solely for the convenience of the reader, this annual report contains translations of certain pounds sterling amounts into US dollars at specified rates. These translations should not be construed as representations by Lloyds TSB Group that the pounds sterling amounts actually represent such US dollar amounts or could be converted into US dollars at the rate indicated or any other rate. Unless otherwise stated, the translations of pounds sterling into US dollars have been made at the noon buying rate in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate ) in effect on 31 December 2005, which was \$1.7188 = £1.00. The Noon Buying Rate on 31 December 2005 differs from certain of the actual rates used in the preparation of the Consolidated Financial Statements, which are expressed in pounds sterling, and therefore US dollar amounts appearing in this annual report may differ significantly from actual US dollar amounts which were translated into pounds sterling in the preparation of the Consolidated Financial Statements in accordance with International Financial Reporting Standards as adopted by the European Union.

**BUSINESS OVERVIEW**

Lloyds TSB Group is a leading UK-based financial services group, whose businesses provide a wide range of banking and financial services in the UK and in certain locations overseas; although, following a number of sales of overseas businesses in recent years, the Lloyds TSB Group's activities are now concentrated in the UK. At 31 December 2005 total Lloyds TSB Group assets were £309,754 million and Lloyds TSB Group had some 67,000 employees. Lloyds TSB Group plc's market capitalisation at that date was some £27,400 million. The profit on ordinary activities before tax for the 12 months to 31 December 2005 was £3,820 million and the risk asset ratios as at that date were 10.9 per cent for total capital and 7.9 per cent for tier 1 capital.

The operations of Lloyds TSB Group in the UK were conducted through over 2,100 branches of Lloyds TSB Bank, Lloyds TSB Scotland plc and Cheltenham & Gloucester plc at the end of December 2005. International business is conducted mainly in the US and continental Europe. Lloyds TSB Group's services in these countries are offered largely through branches of Lloyds TSB Bank. Lloyds TSB Group also offers offshore banking facilities in a number of countries. For additional information see Regulation .

Lloyds TSB Group's activities are organised into three segments: UK Retail Banking, Insurance and Investments and Wholesale and International Banking. Services provided by UK Retail Banking encompass the provision of banking and other financial services to personal customers, private banking and mortgages. Insurance and Investments offers life assurance, pensions and investment products, general insurance and fund management services. Wholesale and International Banking provides banking and related services for major UK and multinational companies, banks and financial institutions, and small and medium-sized UK businesses, including venture capital finance. It also provides asset finance and share registration services to personal and corporate customers, manages Lloyds TSB Group's activities in financial markets through its treasury function and provides banking and financial services overseas.

The following table shows the results of Lloyds TSB Group's UK Retail Banking, Insurance and Investments and Wholesale and International Banking segments and Central group items in each of the last two fiscal years. The impact of adopting International Financial Reporting Standards ( IFRS ), and in particular the increased use of fair values, has resulted in greater earnings volatility. In order to provide a more comparable representation of business performance this volatility has been separately analysed from the results of the individual business units (see Operating and financial review and prospects Results of operations for 2005 and 2004 Volatility ).

|  | 2005<br>£m   | 2004<br>£m |
|--|--------------|------------|
| UK Retail Banking                              | 1,394        | 1,639      |
| Insurance and Investments                      | 725          | 778        |
| Wholesale and International Banking            | 1,518        | 1,272      |
| Central group items                            | (442)        | (350)      |
| <b>Profit before tax, excluding volatility</b> | <b>3,195</b> | 3,339      |
| Volatility*                                    | 625          | 138        |
| <b>Profit before tax</b>                       | <b>3,820</b> | 3,477      |

\* Volatility relates to Insurance and Investments (2005: £749 million; 2004: £138 million) and Central group items (2005: £(124) million; 2004: £nil).

Lloyds TSB Group plc was incorporated as a public limited company and registered in Scotland under the UK Companies Act 1985 on 21 October 1985 with the registered number 95000. Lloyds TSB Group plc's registered office is Henry Duncan House, 120 George Street, Edinburgh EH2 4LH, Scotland, and its principal executive offices in the UK are located at 25 Gresham Street, London, EC2V 7HN, United Kingdom, telephone number + 44 (0) 20 7626 1500.

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SELECTED CONSOLIDATED FINANCIAL DATA

The financial information set out in the tables below has been derived from the annual reports and accounts of Lloyds TSB Group plc for each of the past five years adjusted for subsequent changes in accounting policy and presentation. The financial statements for the year 2001 were audited by PricewaterhouseCoopers, independent accountants; the financial statements for each of the years 2002 to 2005 have been audited by their successor firm PricewaterhouseCoopers LLP, independent accountants.

The financial statements have been prepared in accordance with IFRS which differs in certain significant respects from US Generally Accepted Accounting Principles ( US GAAP ). A discussion of the differences between IFRS and US GAAP and a reconciliation of certain IFRS amounts to US GAAP are included in note 56 to the financial statements.

| IFRS   | 2005    | 2004    |
|--|---------|---------|
| <b>Income statement data for the year ended 31 December (£m)</b> |         |         |
| Net interest income  | 5,671   | 5,110   |
| Other income   | 17,055  | 14,173  |
| Trading surplus  | 5,069   | 4,364   |
| Impairment losses on loans and advances                          | (1,299) | (866)   |
| Profit before tax  | 3,820   | 3,477   |
| Profit for the year  | 2,555   | 2,459   |
| Profit for the year attributable to equity shareholders          | 2,493   | 2,392   |
| Total dividend for the year <sup>1</sup>                         | 1,915   | 1,914   |
| <b>Balance sheet data at 31 December (£m)</b>                    |         |         |
| Share capital  | 1,420   | 1,419   |
| Shareholders' equity   | 10,195  | 11,047  |
| Customer accounts  | 131,070 | 119,811 |
| Undated subordinated loan capital                                | 7,733   | 5,852   |
| Dated subordinated loan capital                                  | 4,669   | 4,400   |
| Loans and advances to customers                                  | 174,944 | 155,318 |
| Total assets   | 309,754 | 284,422 |
| <b>Share information</b>   |         |         |
| Basic earnings per ordinary share                                | 44.6p   | 42.8p   |
| Diluted earnings per ordinary share                              | 44.2p   | 42.5p   |
| Net asset value per ordinary share                               | 180p    | 195p    |
| Total dividend per ordinary share <sup>1</sup>                   | 34.2p   | 34.2p   |
| Equivalent cents per share <sup>1, 2</sup>                       | 62.2c   | 63.7c   |
| Market price (year-end)  | 488.5p  | 473p    |
| Number of shareholders (thousands)                               | 920     | 953     |
| Number of ordinary shares in issue (millions) <sup>3</sup>       | 5,603   | 5,596   |
| <b>Financial ratios (%)<sup>4</sup></b>                          |         |         |
| Dividend payout ratio  | 76.8    | 80.0    |
| Post-tax return on average shareholders' equity                  | 25.6    | 22.8    |
| Post-tax return on average assets                                | 0.84    | 0.92    |
| Post-tax return on average risk-weighted assets                  | 1.81    | 1.99    |
| Average shareholders' equity to average assets                   | 3.2     | 3.9     |
| Cost:income ratio <sup>5</sup>                                   | 51.9    | 54.8    |
| <b>Capital ratios (%)<sup>6</sup></b>                            |         |         |
| Total capital  | 10.9    | 10.1    |
| Tier 1 capital   | 7.9     | 8.2     |

<sup>1</sup> Annual dividends comprise both interim and final dividend payments. For the purposes of the IFRS disclosures in this table, the total dividend for the year represents the interim dividend paid during the year and the final dividend which will be paid and accounted for

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during the following year.

- <sup>2</sup> Translated into US dollars at the Noon Buying Rate on the date each payment was made.
- <sup>3</sup> This figure excludes the 79 million limited voting ordinary shares owned by the Lloyds TSB Foundations.
- <sup>4</sup> Averages are calculated on a monthly basis from the consolidated financial data of Lloyds TSB Group.
- <sup>5</sup> The cost:income ratio is calculated as total operating expenses as a percentage of total income (net of insurance claims).
- <sup>6</sup> In order to provide a more meaningful comparison, capital ratios are shown at 31 December 2005 and 1 January 2005, after the application of those accounting standards applied with effect from 1 January 2005.



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| <b>SELECTED US GAAP FINANCIAL DATA</b>   | <b>2005</b>    | 2004    | 2003    | 2002    | 2001    |
|--|----------------|---------|---------|---------|---------|
| <b>Income statement data for the year ended 31 December (£m)<sup>(1)</sup></b> |                |         |         |         |         |
| Total revenues, net of interest expense  | <b>20,413</b>  | 16,668  | 14,139  | 10,498  | 9,335   |
| Policyholder benefits and claims expense                                       | <b>(7,479)</b> | (4,473) | (3,036) | (1,565) | (2,228) |
| Allowance for loan losses  | <b>(1,613)</b> | (866)   | (950)   | (1,029) | (747)   |
| Income before tax  | <b>2,605</b>   | 3,214   | 4,220   | 2,378   | 2,221   |
| Net income   | <b>1,351</b>   | 1,508   | 3,231   | 1,753   | 1,635   |
| Dividends  | <b>1,914</b>   | 1,913   | 1,908   | 1,903   | 1,738   |
| <b>Balance sheet data at 31 December (£m)</b>                                  |                |         |         |         |         |
| Shareholders' equity   | <b>10,981</b>  | 11,458  | 11,892  | 10,164  | 13,505  |
| Deposits   | <b>162,491</b> | 159,546 | 140,451 | 141,777 | 133,419 |
| Loans, net of provisions   | <b>173,981</b> | 152,428 | 134,043 | 134,202 | 122,485 |
| Total assets   | <b>305,917</b> | 281,598 | 251,158 | 254,352 | 243,187 |
| <b>Share information (pence per ordinary share)</b>                            |                |         |         |         |         |
| Basic earnings   | <b>24.1</b>    | 27.0    | 57.9    | 31.5    | 29.5    |
| Diluted earnings   | <b>24.0</b>    | 26.8    | 57.7    | 31.3    | 29.2    |
| Net asset value  | <b>193</b>     | 202     | 210     | 180     | 240     |
| Dividends  | <b>34.2</b>    | 34.2    | 34.2    | 34.2    | 31.5    |
| <b>Financial ratios (%)<sup>(2)</sup></b>                                      |                |         |         |         |         |
| Dividend payout ratio  | <b>141.7</b>   | 126.9   | 59.1    | 108.6   | 106.4   |
| Post-tax return on average shareholders' equity                                | <b>12.0</b>    | 12.9    | 29.3    | 14.8    | 12.0    |
| Post-tax return on average assets  | <b>0.60</b>    | 0.65    | 1.29    | 0.73    | 0.72    |
| Average shareholders' equity to average assets                                 | <b>3.8</b>     | 4.4     | 4.4     | 4.8     | 5.8     |

(1) For the purposes of this five year summary, income statement items in respect of discontinued operations have been aggregated with those of continuing operations.

(2) Lloyds TSB Group does not have sufficient information to calculate US GAAP average balances on a monthly basis. Where applicable, these financial ratios have been based upon simple averages of the opening and closing balances.

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**EXCHANGE RATES**

In this annual report, unless otherwise indicated, all amounts are expressed in pounds sterling. For the months shown the US dollar high and low Noon Buying Rates per pound sterling were:

|                                | 2006<br>April | 2006<br>March | 2006<br>February | 2006<br>January | 2005<br>December | 2005<br>November |
|--------------------------------|---------------|---------------|------------------|-----------------|------------------|------------------|
| US dollars per pound sterling: |               |               |                  |                 |                  |                  |
| High                           | 1.82          | 1.76          | 1.78             | 1.79            | 1.77             | 1.78             |
| Low                            | 1.74          | 1.73          | 1.73             | 1.74            | 1.72             | 1.71             |

For the years shown the averages of the US dollar Noon Buying Rates per pound sterling on the last day of each month were:

|                                | 2005 | 2004 | 2003 | 2002 | 2001 |
|--------------------------------|------|------|------|------|------|
| US dollars per pound sterling: |      |      |      |      |      |
| Average                        | 1.81 | 1.84 | 1.64 | 1.51 | 1.44 |

On 26 May 2006, the latest practicable date, the US dollar Noon Buying Rate was \$1.857 = £1.00. Lloyds TSB Group makes no representation that amounts in pounds sterling have been, could have been or could be converted into US dollars at that rate or at any of the above rates.

**BUSINESS**

**History and development of Lloyds TSB Group**

The history of Lloyds TSB Bank can be traced back to the 18<sup>th</sup> century when the banking partnership of Taylor and Lloyds was established in the UK. The late 19<sup>th</sup> and early 20<sup>th</sup> centuries were marked by many acquisitions and mergers, significantly increasing the number of banking offices in the UK. In 1988 Lloyds TSB Bank acquired a majority shareholding in Abbey Life Group Plc (renamed Lloyds Abbey Life plc ( LAL )) in return for the sale to LAL of five of Lloyds TSB Bank's businesses; and in 1995 the business of Cheltenham and Gloucester Building Society was acquired.

TSB Group plc became operational in 1986 when, following UK government legislation, the operations of four Trustee Savings Banks and other related companies were transferred to TSB Group plc and its new banking subsidiaries. By 1995, the TSB Group had, either through organic growth or acquisition, developed life and general insurance operations, investment management activities, a motor vehicle hire purchase and leasing operation, and an estate agency business to supplement its retail banking activities.

In 1995, TSB Group plc merged with Lloyds TSB Bank. Under the terms of the merger, the TSB and Lloyds TSB Bank groups were combined under TSB Group plc, which was re-named Lloyds TSB Group plc. In 1999, the businesses, assets and liabilities of TSB Bank plc, the principal banking subsidiary of the TSB Group prior to the merger, and its subsidiary Hill Samuel Bank Limited were vested in Lloyds TSB Bank. In 1996, Lloyds TSB Group acquired the minority interest in LAL. In 2000, Lloyds TSB Group acquired Scottish Widows, for a total consideration of £5,947 million. In addition to being one of the leading providers of banking services in the UK, this transaction also positioned Lloyds TSB Group as one of the leading suppliers of long-term savings and protection products in the UK.

During the last three years, the Lloyds TSB Group has disposed of a number of its overseas operations, as part of the process of managing its portfolio of businesses to focus on its core markets. These disposals have resulted in a significant reduction in the size of the Lloyds TSB Group's international business. For additional information on the Lloyds TSB Group see Business Overview .

**Management and resources**

Lloyds TSB Group recognises that it will create value for its shareholders if it creates value for its customers. Its constant aim is to meet the rapidly changing needs and expectations of its customers. Lloyds TSB Group believes that success depends upon service, consistency and commitment and it aims, wherever possible, to maintain long-term relationships with its customers.

Lloyds TSB Group operates in a marketplace which is continually changing. No organisation can successfully manage change without the support and commitment of its staff. The pace and scope of change will not diminish as competition in the financial services market continues to increase. Lloyds TSB Group recognises that it is the staff of the organisation who have delivered, and will continue to deliver, its success. The Lloyds TSB Group invests a significant amount in training to develop the knowledge and skills of its employees, which it considers to be a key element in the achievement of its overall strategy.

Lloyds TSB Group recognises that long-term success depends on the quality of its management. It is therefore committed to developing the potential of all managers; in particular ensuring that it has the succession management capability to meet future needs for top management. Peter Ayliffe, group executive director, UK Retail Banking, left the board on 31 January 2005 and was replaced by Terri Dial, formerly group executive vice president and member of the management committee of Wells Fargo & Co, who joined the board on 1 June 2005. In the intervening period Mike Fairey acted as group executive director, UK Retail Banking in addition to his other responsibilities.

Two non-executive directors, Dr Chris Gibson-Smith and David Pritchard, left the board on 5 May 2005. Sir Julian Horn-Smith joined the board, as a non-executive director, on 1 January 2005; Jan du Plessis and Lord Leitch joined the board, also as non-executive directors, on 1 October 2005.

Sir Victor Blank, Chairman of GUS and former chairman of Trinity Mirror (until 4 May 2006) joined the board as deputy chairman on 1 March 2006. Sir Victor took over as chairman of the Lloyds TSB Group at the annual general meeting on 11 May 2006, upon the retirement of Maarten van den Bergh.

## **Strategy of Lloyds TSB Group**

The governing objective of Lloyds TSB Group is to maximise shareholder value over time. In an environment of increasing competition and empowered customers, Lloyds TSB Group believes that this shareholder value objective can best be achieved by:

focusing on markets where it can build and sustain competitive advantage;

developing business strategies for those markets which are founded on being profitably different in the way it creates customer value; and

building a high-performance organisation focused on the right goals and the best possible execution of those strategies.

Reflecting this, in 2003 the Lloyds TSB Group put in place a three-phase strategy. In phase 1, now completed, the Lloyds TSB Group focused on enhancing the quality of its earnings by exiting businesses which were not regarded as core or which added unnecessary volatility to its earnings. During this phase, the Lloyds TSB Group divested businesses in New Zealand and Latin America, markets in which it did not expect to be able to build and sustain competitive advantage. In phase 2, Lloyds TSB Group's focus is on accelerating growth by deepening its customer relationships and improving its productivity and in the process building competitive advantage through enhancing its capabilities. This has already resulted in improved earnings growth in the Lloyds TSB Group's core markets. In phase 3, the Lloyds TSB Group will look to leverage its financial strength and enhanced capabilities in new markets.

Lloyds TSB Group remains alert for opportunities to grow inorganically to complement its organic strategies and help provide new opportunities for profitable growth, both in the UK and overseas.

### ***Markets***

Lloyds TSB Group continues to focus on building competitive advantage in its core markets by seeking opportunities to consolidate its position in businesses where it is already strong, through a combination of organic growth and acquisitions, and by divesting businesses in markets where it is not a leader and cannot aspire reasonably to leadership.

### ***Customer value***

In an increasingly competitive financial services market, and with customers able to exercise choice amongst alternative providers, shareholder value creation is closely linked to customer value creation. Shareholder value can only be created by attracting and retaining customers and winning a greater share of their financial services business. Across its main businesses, Lloyds TSB Group has strong core banking franchises, but smaller market shares in associated product areas. The Lloyds TSB Group's strategy is focused on being differentiated in the creation of customer value to win a bigger share of its customers' total financial services spend.

Lloyds TSB Group continues to develop new strategies to leverage the strength of its brands, its multi-channel distribution capability and its enhanced understanding of what its customers want to deliver greater value.

### ***High performance organisation***

Even the best strategies will fail to deliver shareholder value if poorly executed. Lloyds TSB Group has restructured its businesses and reinvigorated its governance and performance management processes to link plans and budgets much more closely to the highest value strategy for each business, to ensure maximum clarity and accountability for execution within all levels of its management team, and to link reward much more closely to performance.

Lloyds TSB Group measures value internally by economic profit growth, a measure of financial performance which signals unambiguously where value is being created or destroyed. It has developed a framework to be able to measure economic equity requirements across all its businesses, taking into account market, credit, insurance, business and operational risk. Economic profit is measured by applying a charge for this economic equity to post-tax earnings. Using economic profit as a key performance measure enables the Group to understand which strategies, products, channels and customer segments are destroying value and which are creating the most value and to make better strategic choices as a result.

## **Business and activities of Lloyds TSB Group**

Lloyds TSB Group's activities are organised into three divisions: UK Retail Banking, Insurance and Investments, and Wholesale and International Banking. The main activities of Lloyds TSB Group's three divisions are described below.

### ***UK Retail Banking***

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UK Retail Banking provides banking, financial services, mortgages and private banking to some 15 million personal customers through the Lloyds TSB Group's multi-channel distribution capabilities.

*Branches.* Lloyds TSB Group provides wide-reaching geographic branch coverage in England, Scotland and Wales, with over 2,100 branches of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester as at the end of 2005.

*Internet banking.* Internet banking provides online banking facilities for personal customers. Some 3.7 million customers have registered to use Lloyds TSB Group's internet banking services. At the end of 2005, these customers were conducting more than 45 million transactions per month online, a 50 per cent increase on 2004.

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*Telephone banking.* Telephone banking continues to grow and Lloyds TSB Group provides one of the largest telephone banking services in Europe. At the end of 2005, some 4.2 million customers had registered to use the services of PhoneBank and the automated voice response service, PhoneBank Express. Lloyds TSB Group's telephone banking centres handled some 69 million calls during 2005.

*Cash machines.* Lloyds TSB Group has one of the largest cash machine networks of any leading banking group in the UK and, at 31 December 2005, personal customers of Lloyds TSB Bank and Lloyds TSB Scotland were able to withdraw cash and check balances through some 4,200 ATMs at branches and external locations around the country. In addition, our personal customers have access to a further 54,000 cash machines via LINK in the UK and to cash machines worldwide through the VISA and MasterCard networks.

*Current accounts.* Lloyds TSB Bank and Lloyds TSB Scotland offer a wide range of current accounts, including interest-bearing current accounts and a range of added value accounts.

*Savings accounts.* Lloyds TSB Bank and Lloyds TSB Scotland offer a wide range of savings accounts and Cheltenham & Gloucester provide retail investments through their branch networks and a postal investment centre.

*Personal loans.* Lloyds TSB Bank and Lloyds TSB Scotland offer a range of personal loans through their branch networks and directly to the customer via the internet and telephone.

*Credit cards.* Lloyds TSB Group provides a range of card-based products and services, including credit and debit cards and card transaction processing services for retailers. Lloyds TSB Group is a member of both the VISA and MasterCard payment systems and has access to the American Express payment system. The Lloyds TSB Group had a 12.4 per cent share of outstanding UK credit card balances at 31 December 2005.

*Mortgages.* Cheltenham & Gloucester is Lloyds TSB Group's specialist residential mortgage provider, offering a range of mortgage products to personal customers through its own branches and those of Lloyds TSB Bank in England and Wales, as well as through the telephone, internet and postal service, C&G TeleDirect. Lloyds TSB Group also provides mortgages through Lloyds TSB Scotland and Scottish Widows Bank. Lloyds TSB Group is one of the largest residential mortgage lenders in the UK on the basis of outstanding balances, with mortgages outstanding at 31 December 2005 of £88,376 million, representing a market share of 9.1 per cent.

*UK Wealth Management.* Private Banking provides a range of tailor-made wealth management services and products to individuals from 28 offices throughout the UK. In addition to asset management, these include tax and estate planning, executor and trustee services, deposit taking, lending and insurance. Shareview Dealing provides retail stockbroking services, personal equity plan and individual savings account (ISA) products.

### ***Insurance and Investments***

Insurance and Investments offers life assurance, pensions and investment products, general insurance and fund management services.

*Life assurance, pensions and investments.* Scottish Widows is Lloyds TSB Group's specialist provider of life assurance, pensions and investment products, which are distributed through Lloyds TSB Bank's branch network, through independent financial advisers and directly via the telephone and the internet. The Scottish Widows brand is the main brand for new sales of Lloyds TSB Group's life, pensions, open ended investment companies and other long-term savings products.

In common with other life assurance companies in the UK, the life and pensions business of each of the life assurance companies in the Lloyds TSB Group is written in a long-term business fund. The main long-term business fund is divided into With-Profits and Non-Profit sub-funds.

With-profits life and pensions products are written from the With-Profits sub-fund. The benefits accruing from these policies are designed to provide a smoothed return to policyholders who hold their policies to maturity through a mix of annual and final (or terminal) bonuses added to guaranteed basic benefits. The guarantees generally only apply on death or maturity. The actual bonuses declared will reflect the experience of the With-Profits sub-fund.

Other life and pensions products are generally written from the Non-Profit sub-fund. Examples include unit-linked policies, annuities, term assurances and health insurance (under which a predetermined amount of benefit is payable in the event of an insured event such as death). The benefits provided by linked policies are wholly or partly determined by reference to a specific portfolio of assets known as unit-linked funds.

*General insurance.* Lloyds TSB General Insurance provides general insurance through the retail branches of Lloyds TSB Bank and Cheltenham & Gloucester, and through a direct telephone operation and the internet. Lloyds TSB General Insurance is one of the leading distributors of household insurance in the UK.

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*Scottish Widows Investment Partnership.* Scottish Widows Investment Partnership manages funds for Lloyds TSB Group's retail life, pensions and investment products. Clients also include corporate pension schemes, local authorities and other institutions in the UK and overseas.

### ***Wholesale and International Banking***

Wholesale and International Banking provides banking and related services for major UK and multinational corporates and financial institutions, and small and medium-sized UK businesses. It also provides asset finance and share registration services to personal and corporate customers, manages Lloyds TSB Group's activities in financial markets through its treasury function and provides banking and financial services overseas.

#### **Wholesale**

*Corporate Markets.* Combining the respective strengths of 2,700 people in Corporate Banking, Structured Finance and Financial Markets, plays an integral role in leveraging and expanding Lloyds TSB Group's customer franchise and building deep, long-lasting relationships with around 16,000 corporate customers.

Corporate Banking manages the core customer franchise, providing a relationship-based financial and advisory service to the corporate marketplace through dedicated regional teams throughout the UK and key strategic locations abroad, including New York. Customers have access to the Lloyds TSB Group's expertise and a broad range of financial solutions. The relationship managers act as a conduit to partners in Corporate Markets and other parts of the Lloyds TSB Group.

Structured Finance comprises the structured asset finance, leveraged lending and private equity and other transactional lending and structuring businesses of Corporate Markets. Structured Finance executes transactions with existing corporate customers as well as introducing new to bank relationships to the franchise.

Financial Markets provides market access to sources of liquidity, hedging tools and investment products on behalf of Lloyds TSB Group and its customers. Financial Markets also provides risk management solutions to corporate customers and structured credit and investment products to the investor community.

*Registrars.* Lloyds TSB Registrars, part of the Corporate Bank, operates as receiving bank and registrar to some of the UK's leading public limited companies. As market leader, it currently maintains the share registers of more than 700 clients, including around 60 per cent of the FTSE 100, managing some 22 million shareholder accounts.

*Asset Finance.* Lloyds TSB Group's asset finance businesses provide individuals and companies with finance through leasing, hire purchase and contract hire packages. Hire purchase, or instalment credit, is a form of consumer financing where a customer takes possession of goods on payment of an initial deposit but the legal title to the goods does not pass to the customer until the agreed number of instalments have been paid and the option to purchase has been exercised. Through its invoice discounting and factoring subsidiary, Lloyds TSB Commercial Finance, Lloyds TSB Group provides working capital finance for its customers. Specialist personal lending, store credit and the Dutton-Forshaw motor dealership group complete this group of businesses. Altogether Asset Finance has over 1.7 million individual customers and relationships with some 40,000 companies and small businesses.

*Business Banking.* A growing business which has relationships with some 587,000 small businesses managed by business managers based in 500 locations throughout the UK. This has been reinforced by an additional 300 business managers moving back into branches. Lloyds TSB Group has a leading share of the new business start-up market, with some 100,000 new businesses opening an account with Lloyds TSB in 2005. The main activity of The Agricultural Mortgage Corporation is to provide long-term finance to the agricultural sector.

#### **International Banking**

The Lloyds TSB Group has continued to shape its international network to support its UK operations.

*Offshore banking.* Lloyds TSB Group's offshore banking operations comprise offices in the UK, the Channel Islands, the Isle of Man, Hong Kong, Singapore, Malaysia and overseas representative offices in the Middle East, Africa, Asia and the Americas. The business provides a wide range of retail banking, wealth management and expatriate services to local island residents, UK expatriates, foreign nationals and to other customers requiring offshore financial services.

*International private banking.* Lloyds TSB Group has international private banking operations for wealthy individuals. The business is conducted through branches of Lloyds TSB Bank located in Switzerland, Luxembourg, Monaco, Gibraltar, Uruguay, Dubai and the US, supported by representative offices in Latin America.

*International corporate banking.* Serves the corporate and institutional market in Europe, the Middle East and Japan through offices in Belgium, the Netherlands, Spain, Dubai and Japan. Lloyds TSB Group continues to have offices in Ecuador and Uruguay which provide mainly corporate banking services. The sale of the business in Paraguay is expected to complete in 2006 after receipt of the required regulatory approval.





**Material contracts**

Lloyds TSB Group and its subsidiaries are party to various contracts in the ordinary course of business. In 2005, there have been no material contracts entered into outside the ordinary course of business.

**Recent developments**

Lloyds TSB Group issued a trading statement at its annual general meeting on 11 May 2006, which made the following comments:

In the first few months of 2006 the Group has maintained good progress in the delivery of its growth strategies. As a result, we are confident that we will deliver a satisfactory performance for the half-year.

**Properties**

As at 31 December 2005, Lloyds TSB Group occupied 3,370 properties in the UK. Of these, 639 were held as freeholds, 69 as long-term leaseholds and 2,662 as short-term leaseholds. The majority of these properties are retail branches, widely distributed throughout England, Scotland and Wales. Other buildings include the Lloyds TSB Group's head office in the City of London, and customer service and support properties located to suit business needs, but clustered largely in London, Birmingham, Bristol (in England), Edinburgh (in Scotland) and Cardiff and Newport (in Wales).

In addition, Lloyds TSB Group owns, leases or uses under licence properties for business operations elsewhere in the world, principally in Spain, Switzerland, Dubai and Asia.

**Legal actions**

Lloyds TSB Group is periodically subject to threatened or filed legal actions in the ordinary course of business. Lloyds TSB Group does not expect the final outcome of any legal proceedings currently known to it to have a material adverse effect on its consolidated results of operations or financial condition.

## Competitive environment

Lloyds TSB Group operates in a financial services world that is experiencing consolidation at national and, to a lesser extent, international levels. The last few years have seen the beginnings of pan-European consolidation and considerable consolidation within the US.

Globalisation and developments in technology continue to expand Lloyds TSB Group's range of competitors. The rising intensity of competition is expected to put Lloyds TSB Group's margins under further pressure with many products becoming increasingly commoditised. Wholesale markets are integrating more rapidly across the European Union than their retail counterparts, leading to a deeper, more liquid, and more competitive corporate securities market, and the gradual disintermediation of traditional bank lending.

Lloyds TSB Group expects competition within the industry to continue to be based on service and relationships as well as price, particularly for core banking services. Lloyds TSB Group has significant strengths, in its portfolio of strong brands, its existing customer franchises in both retail and corporate, commercial and business banking, its multi-channel distribution capability and its knowledge and understanding of its customers.

Lloyds TSB Group's key markets are in the UK, in both the retail and corporate, commercial and business banking sectors, where the markets for basic financial and banking services are relatively mature. Retail banking markets have shown strong rates of growth in recent years, notably in consumer borrowing and mortgages, but the resultant high rates of consumer indebtedness are expected to restrain future growth. The markets for life and pensions and investment products are expected to show strong rates of growth in a number of key areas, although stock market weakness has depressed demand for some equity-based products in the recent past, and a considerable amount of uncertainty exists about the impact of regulatory change. Wholesale markets have shown strong growth recently, and cyclically low levels of bad debt. Going forward, some slowing of market growth is likely, plus a return to more normal levels of bad debt.

Lloyds TSB Group's competitors include all the major financial services and fund management companies operating in the UK. De-mutualised building societies which have become banks and life insurers which have entered the banking market have become direct competitors in the provision of banking products.

In the mortgage market, competitors include the traditional banks and building societies and new entrants to the market, with the market becoming increasingly competitive as both new entrants and incumbents endeavour to gain market share. Lloyds TSB Group's competitors in the credit card market again include both the traditional banks and new entrants, including overseas companies. In the last few years a significant share of new business has been acquired by US and new UK competitors.

In the distribution of life, pensions and investments products Lloyds TSB Group has seen increased competition from new market entrants, such as traditional retailers, primarily in specialist areas. The fragmented nature of the life, pensions and investments market in the UK has resulted in some consolidation within the sector; government regulations on product charges and competitive pressures are likely to drive further consolidation as providers seek to achieve the benefits of economies of scale. Changes to the regulation of life, pensions and investment products are expected to favour distributors, including banks, rather than product providers, although the impact of the recent government sponsored Turner Report findings is not clear.

In the general insurance sector, the market has seen significant consolidation amongst underwriters but continued fragmentation in distribution and an increasing number of new market entrants including both overseas insurers and direct operators.

In commercial and corporate markets, margins are typically finer than in retail, but probably under less overall downward pressure. Nevertheless, traditional forms of bank finance face increasing competition from market-based products as companies increasingly access those markets directly.

In addition to the challenging competitive environment, in the UK and elsewhere, there is continuing political, regulatory and competition scrutiny of banking and, in particular, retail banking.

In the UK, the Office of Fair Trading (OFT) is carrying out several inquiries:

In April 2006, the OFT launched a market study on payment protection insurance (PPI), following a super complaint submitted by the Citizens Advice Bureau in September 2005. The OFT expects to publish its report by the end of 2006.

The OFT has carried out investigations into Visa and MasterCard credit card interchange rates. In the MasterCard interchange case, the OFT decision is being appealed by MasterCard to the Competition Appeals Tribunal and the appeal is expected to be heard towards the end of 2006. The OFT's investigation in the Visa interchange case is at an earlier stage.

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Following discussions with the industry, in April 2006 the OFT issued a statement on default charges in credit card contracts. In this the OFT state that it will not challenge default charges set below £12. This is lower than the current level charged by Lloyds TSB Group and most other card issuers. Lloyds TSB Group does not agree with the OFT's interpretation of the law, but has written to the OFT to confirm that it will be reducing its credit card charges to £12 from 29 June 2006.

In addition to its comments on credit cards, the OFT statement also suggested the same principles should apply to some other consumer contracts such as those for store cards, mortgages and bank accounts. So far as Lloyds TSB Group is aware these matters have not been previously discussed with the industry by the OFT. Lloyds TSB Group has informed the OFT that it strongly disagrees that these principles are applicable to current account charges.

The Competition Commission inquiry in 2002 into the supply of banking services to small and medium-sized enterprises (SMEs), resulted in a number of banks, including Lloyds TSB Group, giving certain undertakings to the OFT. The OFT announced in January 2006 that it would be reviewing these undertakings. The OFT is expected to commence that review in the second quarter of 2006 and anticipates that it will take nine months to complete. Lloyds TSB Group will cooperate fully with that review.

There is a continuing market study by the OFT into payments systems, with the OFT chairing a Payments Systems Task Force. This was established in 2004 to look at competition issues relating to payments systems over a four year period. In December 2005, the OFT welcomed proposals for reducing the clearing times for electronic banking payments. Lloyds TSB Group will continue to co-operate with the Task Force.

In addition, in June 2005, the European Union (EU) announced an inquiry into retail banking. The inquiry will cover the 25 Member states and will be executed in a phased approach. The inquiry is focusing on payment cards, retail banking (including SME banking) and business insurance in Europe generally. Lloyds TSB Group is co-operating with the inquiry and the outcome is unclear, though the European Commission has recently published a preliminary report on payment cards for consultation.

These investigations and any connected matters are likely to affect the industry and have an impact on the Lloyds TSB Group's business. Lloyds TSB Group is considering actions to mitigate any financial impact. The net effect from a product and cost/income perspective is currently under consideration, however, the Lloyds TSB Group is presently unable to quantify with any reasonable certainty the aggregate cost or income implications in relation to the above enquiries.

**OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

*The results discussed below are not necessarily indicative of Lloyds TSB Group's results in future periods. The following information contains certain forward-looking statements. For a discussion of certain cautionary statements relating to forward-looking statements, see Forward-Looking Statements .*

The following discussion is based on and should be read in conjunction with the Consolidated Financial Statements and the related notes thereto included elsewhere in this annual report. For a discussion of the accounting policies used in the preparation of the Consolidated Financial Statements, see Accounting policies in note 1 to the Consolidated Financial Statements. The Consolidated Financial Statements are prepared in accordance with IFRS, which varies in certain significant respects from US GAAP. A discussion of such differences and a reconciliation of certain IFRS amounts to US GAAP is included in note 56 to the Consolidated Financial Statements. Certain information for years prior to 2004 has been prepared under UK GAAP, which is not comparable with IFRS.

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**Overview and trend information**

Lloyds TSB Group has operations in both the UK and overseas; however, its earnings are heavily dependent upon its domestic activities and in 2005 substantially all of Lloyds TSB Group's profit before tax was derived from its UK operations. The state of the UK economy, therefore, has significant implications for the way in which Lloyds TSB Group runs its business and its performance.

After slowing to growth of around 1.7 per cent in 2005, the UK economy is expected to recover to around 2.0 per cent to 2.5 per cent in 2006. Global economic growth is expected to remain robust and domestic consumer spending growth should gradually improve after a period of unchanged interest rates which has stabilised the UK housing market. The pace of recovery is likely to remain restrained, however, as unemployment has started to rise gradually. Increasing global economic imbalances indicate some risks around this outcome however, although continuing low inflation and the sound state of public finances in the UK suggest that the UK economy is well positioned to resist any sudden deterioration in the external environment.

Against this economic backdrop, there has been continued growth in each of Lloyds TSB Group's three divisions: UK Retail Banking, as a result of strong growth in mortgage and customer deposit balances with costs remaining tightly controlled, although impairment charges rose significantly reflecting a marketwide deterioration in retail credit quality as a result of more customers, with higher levels of indebtedness, experiencing repayment difficulties; Insurance and Investments, as a result of increased weighted sales through both the Independent Financial Adviser and bancassurance distribution channels and an increase in the life and pensions new business margin; and Wholesale and International Banking, which has seen significant progress in delivering the strategy to build an integrated wholesale bank for corporate markets, and good levels of new business growth in Business Banking and Asset Finance.

**Critical accounting policies**

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported therein. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates.

The accounting policies that are deemed critical to the Lloyds TSB Group's results and financial position, based upon materiality and significant judgements and estimates, are discussed in note 2 to the Consolidated Financial Statements.

**Results of operations 2005 compared with 2004**

The Lloyds TSB Group has applied IFRS as adopted by the European Union (EU) in its financial statements for the year ended 31 December 2005. IFRSs as adopted by the EU are identical in all respects to the current IFRSs as issued by the IASB, except for the EU's amendment to IAS 39. The Lloyds TSB Group has not taken advantage of the EU's amendment to IAS 39; accordingly, there would be no change to the reported income or equity if Lloyds TSB Group were to adopt fully the current IFRSs as issued by the IASB. The rules for first time adoption of IFRS require the application of certain exceptions and permit certain other transition exemptions; further information is provided on page F-8. The application of these exceptions and exemptions means that the 2004 figures disclosed are not fully comparable with those presented in respect of 2005.

The adoption of IAS 32, IAS 39 and IFRS 4 with effect from 1 January 2005 has also resulted in certain classifications being appropriate for only 2004 or 2005; in order to provide a more meaningful presentation, and to differentiate from a nil balance, shading has been used where a caption is not relevant for a particular year.

**Summary**

|  | 2005<br>£m    | 2004<br>£m |
|--|---------------|------------|
| Net interest income                            | 5,671         | 5,110      |
| Other income                                   | 17,055        | 14,173     |
| <b>Total income</b>                            | <b>22,726</b> | 19,283     |
| Insurance claims                               | (12,186)      | (9,622)    |
| <b>Total income, net of insurance claims</b>   | <b>10,540</b> | 9,661      |
| Operating expenses                             | (5,471)       | (5,297)    |
| <b>Trading surplus</b>                         | <b>5,069</b>  | 4,364      |
| Impairment losses on loans and advances        | (1,299)       | (866)      |
| Profit(loss) on sale and closure of businesses | 50            | (21)       |
| <b>Profit before tax</b>                       | <b>3,820</b>  | 3,477      |
| Taxation                                       | (1,265)       | (1,018)    |
| <b>Profit for the year</b>                     | <b>2,555</b>  | 2,459      |
| Profit attributable to minority interests      | 62            | 67         |
| Profit attributable to equity shareholders     | 2,493         | 2,392      |
| <b>Profit for the year</b>                     | <b>2,555</b>  | 2,459      |
| Economic profit <sup>1</sup>                   | 1,616         | 1,448      |

<sup>1</sup> Lloyds TSB Group defines economic profit as the earnings on the equity invested in the business less a notional charge for the cost of the equity invested in that business. See Operating and financial review and prospects Economic profit .

In 2005 the Lloyds TSB Group's profit before tax was £3,820 million, an increase of £343 million, or 10 per cent, compared to £3,477 million in 2004. Profit attributable to shareholders was £101 million, or 4 per cent, higher at £2,493 million compared to £2,392 million in 2004. Earnings per share were 44.6p compared to 42.8p in 2004, an increase of 4 per cent.

Net interest income was £561 million, or 11 per cent, higher at £5,671 million compared to £5,110 million in 2004. The international accounting standards implemented with effect from 1 January 2005 have had a marked effect on the Lloyds TSB Group's net interest income as certain amounts previously accounted for within fees receivable and administrative expenses are now included within the effective interest rate



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calculations. Adjusting for this effect, underlying net interest income was £403 million, or 8 per cent, higher. Average interest-earning assets increased as a result of continued strong lending growth, particularly in respect of mortgages, personal loans and credit cards as well as corporate lending and asset finance. The Lloyds TSB Group's net interest margin fell by 10 basis points to 2.62 per cent; however if the impact of the accounting standards applied with effect from 1 January 2005 and the growth in reverse repurchase agreement balances are excluded, the underlying net interest margin was 2.82 per cent in 2005, compared to 2.86 per cent in 2004; a fall of 4 basis points. This fall in the underlying margin reflected competitive pressures in both the personal and corporate lending books.

Other income, at £17,055 million, was £2,882 million, or 20 per cent, higher than £14,173 million in 2004. Fees and commissions receivable were £64 million, or 2 per cent, lower at £2,990 million; however, if the effect of the accounting standards applied with effect from 1 January 2005 are excluded, underlying fees and commissions receivable were £261 million, or 9 per cent, higher at £3,315 million compared to £3,054 million in 2004. The increase in underlying fee income reflects good growth in current account fees, mortgage and other lending fees and wealth management products. Fees and commissions payable, again excluding the impact of the accounting standards applied with effect from 1 January 2005, were £74 million higher, largely as a result of increased volumes within Scottish Widows. Net trading income was £4,262 million higher, principally within the insurance and investment businesses, and insurance premium income (excluding the impact of the accounting standards applied with effect from 1 January 2005) was £1,131 million higher. These increases reflect substantial inflows of funds from policyholders and strong investment gains over the year; this income, however, is largely for the benefit of policyholders and is matched by the commensurate increase in insurance claims.

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Insurance claims, at £12,186 million, were £2,564 million, or 27 per cent, higher than £9,622 million in 2004. The impact of the accounting standards applied with effect from 1 January 2005 in respect of the insurance businesses caused a significant reduction in both the premium income and claims figures, as a large number of insurance products were reclassified as investment products. Adjusting for this effect, underlying insurance claims were £5,172 million, or 54 per cent, higher at £14,794 million compared to £9,622 million in 2004.

Operating expenses were £174 million, or 3 per cent, higher at £5,471 million compared to £5,297 million in 2004. Staff costs were £151 million, or 6 per cent, higher reflecting annual pay awards, increased bonus and incentive payments in certain areas as a result of business success and increased severance costs in relation to rationalisation programmes. Staff numbers, on a full time equivalent basis, decreased by 3,188 to 66,797 at 31 December 2005 compared to 69,985 at 31 December 2004; however, much of this fall occurred towards the end of the year and consequently there was little impact on staff costs. Premises and equipment costs were £35 million higher. Other costs were £19 million lower; an increase of £38 million in the charge in respect of provisions for customer redress, following a review of the expected cost by the Lloyds TSB Group, was more than offset by a net credit of £45 million in respect of deferred acquisition costs within the insurance businesses.

Impairment losses on loans and advances, at £1,299 million, were £433 million, or 50 per cent, higher than 2004. Excluding the impact of the accounting standards applied with effect from 1 January 2005 and a small release of £3 million from other credit risk provisions, underlying impairment losses on loans and advances were £227 million, or 26 per cent, higher at £1,093 million in 2005 compared to £866 million in 2004. The overall charge in respect of Wholesale and International Banking was little changed with the majority of the increase arising within UK Retail Banking. The underlying impairment charge in UK Retail Banking was £229 million higher as a result of volume growth in both personal loans and credit card lending, the absence of a mortgage related provision release which in 2004 totalled £39 million, and the impact of more customers with higher levels of indebtedness experiencing repayment difficulties.

A net profit of £50 million arose on the sale and closure of businesses in 2005, principally as a result of the disposal of the Goldfish credit card portfolios, compared to a loss of £21 million in 2004, which largely reflected the sale of the Lloyds TSB Group's businesses in Argentina and Colombia.

The tax charge, at £1,265 million, represented 33.1 per cent of profit before tax compared to 29.3 per cent in 2004; the increase in the effective tax rate largely reflects the IFRS requirement to include, within the tax charge, tax attributable to UK life insurance policyholder earnings and interests in Open Ended Investment Companies (OEICs).

At the end of 2005, the total capital ratio was 10.9 per cent. Risk-weighted assets increased by £13,091 million, or 10 per cent, since the beginning of 2005 to £144,921 million at the end of the year; this increase reflected new mortgage and other personal lending together with substantial growth in corporate, SME, asset finance and structured finance lending. Total assets grew by £25,332 million, or 9 per cent, to £309,754 million compared to £284,422 million at 31 December 2004. Of this growth, £9,649 million was due to the grossing-up of balances no longer eligible for set-off following the implementation of IAS 32 with effect from 1 January 2005. The remaining increase of £15,683 million was due to the lending growth and higher securities balances within the long-term insurance business.

## Net interest income

|   | 2005    | 2004    |
|---|---------|---------|
| Net interest income £m  | 5,671   | 5,110   |
| Average interest-earning assets £m  | 216,153 | 187,643 |
| Average rates:  |         |         |
| Gross yield on interest-earning assets %  | 5.82    | 5.71    |
| Interest spread %   | 2.40    | 2.50    |
| Net interest margin %   | 2.62    | 2.72    |
| Margin excluding average balances held under reverse repurchase agreements <sup>4</sup> : |         |         |
| Net interest income £m  | 5,671   | 5,110   |
| Average interest-earning assets £m  | 201,813 | 178,887 |
| Net interest margin %   | 2.81    | 2.86    |

<sup>1</sup> Gross yield is the rate of interest earned on average interest-earning assets.

<sup>2</sup> Interest spread is the difference between the rate of interest earned on average interest-earning assets and the rate of interest paid on average interest-bearing liabilities.

<sup>3</sup> The net interest margin represents the interest spread together with the contribution of interest-free liabilities. It is calculated by expressing net interest income as a percentage of average interest-earning assets.

<sup>4</sup> Comparisons of net interest income and margins are impacted by the holdings of fine margin reverse repurchase agreements. To improve comparability, figures are also shown excluding average balances held under reverse repurchase agreements (2005: £14,340 million; 2004: £8,756 million)

Net interest income increased by £561 million, or 11 per cent, to £5,671 million compared to £5,110 million in 2004. However, net interest income is impacted by the accounting standards applied with effect from 1 January 2005 and adjusting for this, net interest income was £403 million, or 8 per cent, higher at £5,513 million compared to £5,110 million in 2004.

Average interest-earning assets grew by £28,510 million, or 15 per cent, to £216,153 million in 2005 compared to £187,643 million in 2004. However, comparisons are distorted by the substantial growth, during 2004 and 2005, in assets held under reverse repurchase agreements for liquidity purposes. Excluding the balances held under reverse repurchase agreements, average interest-earning assets grew by £22,926 million, of which the grossing-up of balances subject to set-off arrangements in 2005 following the implementation of IAS 32 accounted for £6,396 million. The underlying growth in average interest-earning assets was therefore £16,530 million, or 9 per cent, adding £475 million to net interest income. Good levels of consumer lending growth increased average personal lending and credit card balances by £1,691 million and average mortgage balances by £7,808 million. Average interest-earning assets within the insurance and investment businesses, which include policyholder and long-term fund balances, increased by £1,891 million as a result of business growth and increased fund activity. Strong lending growth led to an increase of £4,373 million in average interest-earning assets in the Business Banking and Corporate Markets franchises and average balances in Asset Finance were £484 million higher, reflecting the full year impact of lending growth over 2004.

The Lloyds TSB Group's net interest margin fell by 10 basis points to 2.62 per cent in 2005, compared to 2.72 per cent in 2004; if the average balances held under reverse repurchase agreements are excluded from both years, the margin in 2005 was 5 basis points lower at 2.81 per cent compared to 2.86 per cent in 2004. After taking into account the impact of the accounting standards applied with effect from 1 January 2005 the underlying margin fell by 4 basis points reducing net interest income by £72 million. The underlying net interest margin in UK Retail Banking was 23 basis points lower, as a result of competitive pressures and a reduced benefit from current account funding balances. Within Wholesale and International Banking the underlying net interest margin was 5 basis points higher. On this basis, margins on treasury balances improved, as a result of a change in mix; the margin in Structured Finance improved as a result of the impact of new transactions; Corporate Banking margins were lower, as a result of competitive pressures on new lending balances; and margins were also down in Business Banking.

**Other income**

|                                    | 2005<br>£m    | 2004<br>£m |
|------------------------------------|---------------|------------|
| Fees and commissions receivable:   |               |            |
| UK current account fees            | 593           | 637        |
| Other UK fees and commissions      | 1,041         | 1,087      |
| Insurance broking                  | 681           | 672        |
| Card services                      | 545           | 520        |
| International fees and commissions | 130           | 138        |
|                                    | <b>2,990</b>  | 3,054      |
| Fees and commissions payable       | (842)         | (844)      |
| Net trading income                 | 9,298         | 5,036      |
| Insurance premium income           | 4,469         | 6,070      |
| Other operating income             | 1,140         | 857        |
| <b>Total other income</b>          | <b>17,055</b> | 14,173     |

Other income was £2,882 million, or 20 per cent, higher at £17,055 million compared to £14,173 million in 2004.

Fees and commissions receivable were £64 million, or 2 per cent, lower at £2,990 million compared to £3,054 million in 2004. However, year-on-year comparisons are affected by the impact of IAS 39, which has been applied with effect from 1 January 2005 and has resulted in some £325 million of income previously classified within fees and commissions now being included within net interest income via the effective interest rate calculations. Adjusting for this, underlying fees and commissions receivable were £261 million, or 9 per cent, higher at £3,315 million compared to £3,054 million in 2004. Underlying UK current account fees were £117 million higher reflecting continuing growth in added value account products, the impact of pricing reviews in 2004 and 2005 and increased charges in respect of returned cheques and unauthorised borrowings. Also on this underlying basis, other UK fees and commissions were up £114 million, or 10 per cent, at £1,201 million compared to £1,087 million in 2004, reflecting increased levels of mortgage-related fees, increased wealth management fees as a result of higher sales and improved retention rates and increased levels of corporate lending and other fees. Insurance broking income was £9 million, or 1 per cent, higher at £681 million, compared to £672 million in 2004, as lower levels of loan protection income were more than offset by increased income in respect of motor insurance and retrospective commissions. Fees for card services were £25 million higher as a result of increased volumes and some tariff changes.

Fees and commissions payable were £2 million lower at £842 million compared to £844 million in 2004; however, adjusting for fees payable of £76 million included within the effective interest rate calculations in 2005, underlying fees payable were £74 million, or 9 per cent, higher at £918 million compared to £844 million in 2004. The impact of increased business and trading volumes within Scottish Widows more than offset the lower level of dealership commissions within Asset Finance as a result of reduced new business levels.

Net trading income increased by £4,262 million, or 85 per cent, to £9,298 million compared to £5,036 million in 2004. The majority of this increase is attributable to the insurance businesses and reflects significant trading gains on policyholder investments over the year, which are largely matched by an increase in claims expense.

Insurance premium income was £1,601 million, or 26 per cent, lower at £4,469 million compared to £6,070 million in 2004. However, year-on-year comparisons are affected by the impact of IFRS 4, which has caused a significant proportion of contracts to be reclassified as investment products with effect from 1 January 2005. Adjusting for this, underlying insurance premium income was £1,131 million, or 19 per cent, higher at £7,201 million in 2005. Long-term insurance income grew substantially as a result of strong sales through the bancassurance and independent financial advisor channels; however general insurance premium income was little changed as growth in creditor insurance income was largely offset by reduced levels of health insurance premiums.

Other operating income was £283 million, or 33 per cent, higher at £1,140 million compared to £857 million in 2004; excluding the impact of accounting standards applied with effect from 1 January 2005, underlying other operating income was £139 million, or 16 per cent, higher in 2005. Income from investment properties was £114 million higher, in part reflecting portfolio growth, and there were increased gains from the sale and leaseback of premises.

## Operating expenses

|   | 2005<br>£m   | 2004<br>£m   |
|---|--------------|--------------|
| Administrative expenses:                    |              |              |
| Staff:                                      |              |              |
| Salaries                                    | 2,068        | 1,970        |
| National insurance                          | 154          | 144          |
| Pensions                                    | 308          | 307          |
| Other staff costs                           | 325          | 283          |
|   | <b>2,855</b> | <b>2,704</b> |
| Premises and equipment:                     |              |              |
| Rent and rates                              | 305          | 294          |
| Hire of equipment                           | 13           | 17           |
| Repairs and maintenance                     | 136          | 129          |
| Other                                       | 152          | 131          |
|   | <b>606</b>   | <b>571</b>   |
| Other expenses:                             |              |              |
| Communications and external data processing | 467          | 449          |
| Advertising and promotion                   | 207          | 205          |
| Professional fees                           | 216          | 223          |
| Provisions for customer redress             | 150          | 112          |
| Other                                       | 325          | 395          |
|   | <b>1,365</b> | <b>1,384</b> |
| Administrative expenses                     | <b>4,826</b> | 4,659        |
| Depreciation                                | <b>639</b>   | 638          |
| Impairment of goodwill                      | <b>6</b>     |              |
| <b>Total operating expenses</b>             | <b>5,471</b> | <b>5,297</b> |
| Cost: income ratio (%)*                     | <b>51.9</b>  | 54.8         |

\* Total operating expenses divided by total income, net of insurance claims  
**2005 compared with 2004**

Operating expenses were £174 million, or 3 per cent, higher at £5,471 million compared to £5,297 million in 2004.

Staff costs were £151 million, or 6 per cent, higher at £2,855 million compared to £2,704 million in 2004. Salaries were £98 million higher at £2,068 million reflecting annual pay awards and an increase in levels of bonus and incentive payments in some parts of the Lloyds TSB Group. A reduction in overall staff numbers had little impact upon costs as this was biased towards the end of the year. National insurance costs were £10 million higher, reflecting the increase in salary costs, but pension costs were largely unchanged as a decrease in the charge in respect of defined benefit schemes was offset by an increase in cash payments to defined contribution schemes. Other staff costs were £42 million higher as decreases in agency and other costs were more than offset by an increase in severance charges, reflecting rationalisation programmes in a number of parts of the Lloyds TSB Group.

Premises and equipment costs were £35 million, or 6 per cent, higher at £606 million compared to £571 million in 2004. Rent and rates were £11 million higher as a result of general increases in property rental charges and a higher level of costs in relation to the expanding investment property portfolios within the insurance operations. A small decrease in equipment hire charges resulted from a favourable renegotiation of certain contracts, but this has been more than offset by increased repairs and maintenance expenditure, in particular in relation to ATM's and network costs. Other premises and equipment costs were £21 million higher as a result of increased energy costs and other increased costs in relation to the investment property portfolios.

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Other expenses were £19 million, or 1 per cent, lower at £1,365 million compared to £1,384 million in 2004. Communications and external data processing costs were £18 million higher as a result of increased network charges. Advertising costs were little changed at £207 million and professional fees were £7 million lower, reflecting some reduction in consultancy charges. The charge of £150 million in 2005 in respect of provisions for customer redress (£38 million higher than the £112 million charge in 2004) follows a review by the Lloyds TSB Group of the estimated cost of redress payments to customers, principally relating to past sales of mortgage endowment policies through the branch network. This review took in to account the introduction of time barring and the consequent increase in claims. Other costs were £70 million lower at £325 million. Much of this decrease reflected a credit of £45 million representing the net movement in deferred acquisition costs relating to the insurance businesses, the accounting for which has changed as a result of the prospective IFRS accounting changes applied with effect from 1 January 2005. There were efficiency savings in stationery and other administrative costs and costs were also lower following the sale of certain Latin American businesses towards the end of 2004.

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The depreciation charge was little changed at £639 million as a small reduction in the charge in respect of operating lease assets was offset by the effect of general portfolio growth in relation to own-use assets. There was a goodwill impairment charge in relation to an acquisition made in earlier years.

The cost:income ratio improved to 51.9 per cent in 2005 compared to 54.8 per cent in 2004.

### Impairment losses on loans and advances

|   | 2005<br>£m   | 2004<br>£m |
|---|--------------|------------|
| Impairment losses on loans and advances   | 1,302        | 866        |
| Other credit risk provisions  | (3)          |            |
| <b>Impairment losses on loans and advances and other credit risk provisions</b> | <b>1,299</b> | <b>866</b> |

|   | 2005<br>£m   | 2004<br>£m |
|---|--------------|------------|
| <b>Impairment losses on loans and advances</b>                  |              |            |
| UK Retail Banking   | 1,111        | 676        |
| Insurance and Investments                                       |              | (3)        |
| Wholesale and International Banking                             | 191          | 193        |
| <b>Total charge for impairment losses on loans and advances</b> | <b>1,302</b> | <b>866</b> |

| Charge as % of average lending:            | %    | %    |
|--|------|------|
| - Total charge                             | 0.76 | 0.59 |
| - Total charge, excluding impact of IAS 39 | 0.66 | 0.59 |

The impairment charge in respect of loans and advances and other credit risk provisions was £433 million, or 50%, higher at £1,299 million compared to £866 million in 2004. This represents a charge in respect of loans and advances of £1,302 million slightly offset by a release of £3 million from provisions held in respect of contingent liabilities and commitments.

The impairment charge in respect of loans and advances in 2005 was significantly affected by the adoption of the requirements of IAS 39 with effect from 1 January 2005. IAS 39 requires the impairment provision to be calculated by comparing the carrying value of the loan with the discounted value of future cashflows. As a result, in circumstances where a customer's borrowings have been rescheduled onto a concessionary rate which is below market interest rate, an impairment allowance will be required even where full recovery of the principal is anticipated; this had the effect of increasing the 2005 charge by £209 million.

Excluding this effect, underlying impairment losses on loans and advances in 2005 totalled £1,093 million, £227 million or 26 per cent higher than £866 million in 2004.

The underlying charge in UK Retail Banking rose by £229 million, or 34 per cent, to £905 million in 2005. The charges in respect of personal loans and overdrafts and credit cards increased by £112 million and £65 million respectively as a result of volume growth and some deterioration in credit quality as increasing numbers of customers are experiencing repayment difficulties. There was a charge of £13 million in respect of the mortgage portfolio, compared to a release of £39 million in 2004.

The underlying charge in Wholesale and International Banking was £188 million compared to £193 million in 2004. The underlying charge within Corporate Markets was £91 million lower as a result of lower new provisions and maintaining a good level of recoveries; this was partially offset by higher charges in Asset Finance. The charge within Business Banking, which deals with small business customers, was little changed. Within International Banking, there was a credit of £15 million in 2005 compared to a credit of £39 million in 2004; both years benefited from good recoveries in Latin America although 2004 also benefited from a release of £30 million from the Lloyds TSB Group's centrally held provision in respect of exposures in Argentina.

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Overall, the Lloyds TSB Group's charge in respect of impairment losses on loans and advances expressed as a percentage of average lending increased to 0.76 per cent compared to 0.59 per cent in 2004; although excluding the impact of IAS 39 the charge represented 0.66 per cent of average lending in 2005.



**Taxation**

|                                       | 2005<br>£m   | 2004<br>£m   |
|---------------------------------------|--------------|--------------|
| <b>UK corporation tax:</b>            |              |              |
| Current tax on profits for the year   | 862          | 759          |
| Adjustments in respect of prior years | (20)         | (69)         |
|                                       | <b>842</b>   | <b>690</b>   |
| Double taxation relief                | (138)        | (57)         |
|                                       | <b>704</b>   | <b>633</b>   |
| <b>Foreign tax:</b>                   |              |              |
| Current tax on profits for the year   | 78           | 118          |
| Adjustments in respect of prior years | (8)          | (2)          |
|                                       | <b>70</b>    | <b>116</b>   |
| <b>Current tax charge</b>             | <b>774</b>   | <b>749</b>   |
| Deferred tax                          | 491          | 269          |
| <b>Total charge</b>                   | <b>1,265</b> | <b>1,018</b> |

The rate of tax is influenced by the geographic and business mix of profits. The effective rate of tax in 2005 was 33.1 per cent, compared to an effective rate of tax in 2004 of 29.3 per cent and the corporation tax rate in 2005 of 30 per cent. The effective tax rate is distorted by the requirement to include, within the income tax expense, policyholders' tax and Open Ended Investment Company interests of £318 million (2004: £47 million); excluding these the effective tax rate in 2005 was 27.0 per cent compared to 28.3 per cent in 2004. The reduced effective tax rate in 2005 on this adjusted basis was primarily due to tax benefits arising on disposal and other gains. Lloyds TSB Group does not expect the tax rate, excluding the impact of policyholders' tax and Open Ended Investment Company interests, to vary significantly from the average UK corporation tax rate.

**Economic profit**

In pursuit of the Group's aim to maximise shareholder value over time, management has for a number of years used a system of value based management as a framework to identify and measure value creation. Management uses economic profit, a non-GAAP measure, as a measure of performance, and believes that it provides important information for investors, because it captures both growth in investment and return; profit before tax is the comparable GAAP measure used by management. Lloyds TSB Group defines economic profit as the earnings on the equity invested in the business less a notional charge for the cost of the equity invested in that business.

Lloyds TSB Group believes that economic profit instils financial discipline in determining investment decisions throughout Lloyds TSB Group and that it enables Lloyds TSB Group to evaluate alternative strategies objectively, with a clear understanding of the value created by each strategy, and then to select the strategy which creates the greatest value. Awards to senior executives under Lloyds TSB Group's annual bonus arrangements are partly determined by the achievement of economic profit targets.

Management changes its estimates of the cost of equity only to reflect significant changes in long-term interest rates and other external market factors which are considered sustainable. The principal factor in estimating the cost of equity is sustainable long-term interest rates. If long-term interest rates increase, management will consider raising its estimate of the cost of equity; if long-term interest rates fall, management will consider reducing its estimate of the cost of equity. The principal other external market factors considered are equity risk premium and Lloyds TSB Group's share price volatility relative to the UK stock market as a whole. Any change to the estimated cost of equity will be disclosed. For the last two years, management has used a cost of equity of 9 per cent to reflect the shareholders' minimum required rate of return on equity invested.

The table below summarises Lloyds TSB Group's calculation of economic profit for the years indicated.

| 2005<br>£m | 2004<br>£m |
|------------|------------|
|------------|------------|

|  |              |              |
|--|--------------|--------------|
| Average shareholders' equity               | 9,747        | 10,493       |
| Profit attributable to equity shareholders | 2,493        | 2,392        |
| Less: notional charge                      | (877)        | (944)        |
| <b>Economic profit</b>                     | <b>1,616</b> | <b>1,448</b> |

The notional charge has been calculated by multiplying average shareholders' equity by the cost of equity.

Economic profit increased to £1,616 million in 2005 compared to £1,448 million in 2004. Profit attributable to equity shareholders increased by £101 million, or 4 per cent, to £2,493 million; the notional charge on average equity, however, was £67 million lower, as a result of a 7 per cent decrease in average equity to £9,747 million compared to £10,493 million in 2004. The decrease in average equity primarily reflects the decrease of £1,558 million arising from the implementation of IAS 32, IAS 39 and IFRS 4 with effect from 1 January 2005.

**Line of business information****Summary**

The impact of IFRS, and in particular the increased use of fair values, has resulted in greater earnings volatility. In order to provide a more comparable representation of business performance this volatility has been separately analysed from the results of the individual business units. The results of the businesses are set out below:

|   | <b>2005</b>  | 2004  |
|---|--------------|-------|
|   | <b>£m</b>    | £m    |
| UK Retail Banking                       | <b>1,394</b> | 1,639 |
| Insurance and Investments               | <b>725</b>   | 778   |
| Wholesale and International Banking     | <b>1,518</b> | 1,272 |
| Central group items                     | <b>(442)</b> | (350) |
| Profit before tax, excluding volatility | <b>3,195</b> | 3,339 |
| Volatility                              | <b>625</b>   | 138   |
| <b>Profit before tax</b>                | <b>3,820</b> | 3,477 |

Comparative figures for 2004 have been restated to reflect the adoption of those IFRS standards which are required to be applied retrospectively, but do not reflect the additional impacts arising from first time application of IAS 32 Financial Instruments: Disclosure and Presentation, IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts (including UK Financial Reporting Standard 27 Life Assurance), which have been implemented with effect from 1 January 2005, with the opening balance sheet at that date adjusted accordingly.

## UK Retail Banking

|   | 2005<br>£m   | 2004<br>£m |
|---|--------------|------------|
| Net interest income                     | 3,521        | 3,228      |
| Other income                            | 1,605        | 1,696      |
| <b>Total income</b>                     | <b>5,126</b> | 4,924      |
| Operating expenses                      | (2,697)      | (2,609)    |
| Trading surplus                         | 2,429        | 2,315      |
| Impairment losses on loans and advances | (1,111)      | (676)      |
| Profit on sale of businesses            | 76           |            |
| <b>Profit before tax</b>                | <b>1,394</b> | 1,639      |
| Cost:income ratio                       | 52.6%        | 53.0%      |
| Total assets (year-end)*                | £103,930m    | £96,472m   |
| Total risk-weighted assets (year-end)*  | £ 60,582m    | £57,241m   |

\* To ensure comparability, prior year asset and risk-weighted asset figures are shown as at 1 January 2005, following implementation of those international accounting standards for which restated comparatives are not required.

Profit before tax from UK Retail Banking decreased by £245 million, or 15 per cent, to £1,394 million, compared to £1,639 million in 2004. However, comparisons of performance are affected by the impact of the accounting standards implemented with effect from 1 January 2005, which has reduced the profit of UK Retail Banking in 2005 by £213 million; excluding this profit before tax was £1,607 million in 2005 which was £32 million, or 2 per cent, lower than 2004.

Net interest income was £293 million, or 9 per cent, higher at £3,521 million compared to £3,228 million; excluding the impact of IAS 39 which was implemented with effect from 1 January 2005, net interest income was £79 million, or 2 per cent, higher at £3,307 million. During 2005, good levels of growth were achieved in all key product areas. Gross new mortgage lending for the Group totalled £25,979 million; net new lending totalled £8,311 million resulting in a market share of net new lending of 9.1 per cent, and mortgage balances outstanding increased by 10 per cent to £88,376 million. Personal loan balances outstanding at the year-end were £11,023 million, an increase of 3 per cent and credit card balances totalled £7,209 million, an increase of 9 per cent, after adjusting to exclude the effect of the Goldfish disposal. Credit balances on current accounts and savings and investment accounts increased by 7 per cent. The benefit of this volume growth was, however, partly offset by reduced margins on mortgages and personal loans, as a result of competitive pressures.

Other income was £91 million, or 5 per cent, lower at £1,605 million compared to £1,696 million in 2004; however, excluding the effect of those accounting standards applied with effect from 1 January 2005 other income was £115 million, or 7 per cent, higher at £1,811 million. This increase in underlying other income reflects growth in current accounts fees, due to the continuing success of added-value accounts and the benefit of tariff reviews; increased card fee income, particularly in relation to overseas-use charges; and income from the successful new wealth management products.

Operating expenses were £88 million, or 3 per cent, higher at £2,697 million. Of this increase, £50 million is as a result of an increased charge in respect of customer redress, mainly relating to past sales of endowment products through the branch network, following a review by the Lloyds TSB Group of the expected total cost, in the light of the introduction of time-barring and a consequent increase in claims. Underlying operating expenses remain well controlled with the residual increase being largely attributable to higher levels of restructuring costs as back office operations continue to be rationalised.

Impairment losses on loans and advances, at £1,111 million, were £435 million or 64 per cent higher than 2004. The impact of the accounting standards applied with effect from 1 January 2005 accounted for £206 million of this increase; excluding this underlying impairment losses were £229 million, or 34 per cent, higher at £905 million in 2005. The charge in respect of personal loans, overdrafts and credit cards increased as a result of volume growth over recent years as well as some deterioration in credit quality as increasing numbers of customers, with higher levels of indebtedness, are experiencing repayment difficulties. Within the mortgage business there continued to be a low level of losses and as a result the impairment charge was £13 million, compared to a release of £39 million in 2004. Cheltenham & Gloucester (C&G) continued to focus on

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prime lending market segments during 2005. The average indexed loan-to-value ratio for C&G new mortgages and further advances written during 2005 was 64 per cent. At 31 December 2005, 95 per cent of C&G mortgage balances had an indexed loan-to-value ratio of less than 85 per cent and only 0.6 per cent of balances had an indexed loan-to-value ratio in excess of 95 per cent.

A profit of £76 million arose in 2005 on the disposal of the Goldfish credit card business.

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### Insurance and Investments

Lloyds TSB Group's insurance and investments activities comprise the life, pensions and OEICs businesses of Scottish Widows and Abbey Life, general insurance underwriting and broking, and Scottish Widows Investment Partnership.

|  | 2005<br>£m    | 2004<br>£m |
|--|---------------|------------|
| Net interest income  | 389           | 283        |
| Other income   | 13,116        | 10,736     |
| <b>Total income</b>  | <b>13,505</b> | 11,019     |
| Insurance claims   | (12,186)      | (9,622)    |
| <b>Total income, net of insurance claims</b>                                   | <b>1,319</b>  | 1,397      |
| Operating expenses   | (594)         | (622)      |
| <b>Trading surplus</b>   | <b>725</b>    | 775        |
| Impairment losses on loans and advances - credit                               |               | 3          |
| <b>Profit before tax, excluding volatility</b>                                 | <b>725</b>    | 778        |
| Volatility   | 749           | 138        |
| <b>Profit before tax</b>   | <b>1,474</b>  | 916        |
| <b>Analysis by area of business of profit before tax, excluding volatility</b> |               |            |
| Life, pensions and OEICs   | 500           | 598        |
| General insurance  | 209           | 172        |
| Scottish Widows Investment Partnership   | 16            | 8          |
| <b>Profit before tax, excluding volatility</b>                                 | <b>725</b>    | 778        |

### 2005 compared to 2004

Profit before tax from the Lloyds TSB Group's Insurance and Investments businesses was £1,474 million which was £558 million, or 61 per cent, higher than £916 million in 2004. However, much of this increase is due to volatility arising from market movements (see Operating and financial review and prospects - Line of business information - Volatility) and profit before tax excluding volatility was £53 million, or 7 per cent, lower at £725 million compared to £778 million in 2004. The 2005 results were reduced by a provision of £155 million for the strengthening of mortality reserves. The impact of the new accounting standards applied with effect from 1 January 2005 has been to reduce profit before tax, excluding volatility, by £73 million; excluding this effect profit before tax was £20 million, or 3 per cent, higher at £798 million compared to £778 million in 2004.

Net interest income, excluding volatility, was £106 million, or 37 per cent, higher at £389 million compared to £283 million in 2004. This increase reflected higher average levels of cash deposit investments in long-term business and policyholder funds.

Other income, excluding volatility, was £2,380 million, or 22 per cent, higher at £13,116 million compared to £10,736 million in 2004. One of the impacts of the application of IFRS 4 with effect from 1 January 2005 has been the need to reclassify as investment contracts certain transactions that were previously treated as insurance contracts. This has resulted in a decrease in other income largely offset by a decrease in insurance claims. Adjusting for this effect, underlying other income in 2005 was £15,820 million which was £5,084 million, or 47 per cent, higher than £10,736 million in 2004. This increase in underlying other income is principally due to a £1,131 million increase in insurance premium income, reflecting improved sales and increased policyholder activity, together with a £3,728 million increase in net trading income. Net trading income represents the realised and unrealised gains on investments held in the long-term funds, together with the interest and dividend income on those investments and the significant increase in 2005 reflects improved market returns.

The increase in premium income and trading income are largely offset by a matching increase in insurance claims, reflecting the fact that the majority of the premium inflows and investment gains are for the benefit of policyholders. Insurance claims were £2,564 million, or 27 per cent,

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higher at £12,186 million in 2005 compared to £9,622 million in 2004. If the 1 January 2005 reclassifications to investment contracts, described above, are excluded underlying insurance claims were £5,172 million, or 54 per cent, higher at £14,794 million in 2005, compared to £9,622 million in 2004.

Operating expenses reduced by £28 million, or 5 per cent, from £622 million in 2004 to £594 million in 2005. This decrease reflects the absence of a charge in respect of customer redress (£12 million in 2004) and a net credit in respect of deferred acquisition costs of £45 million in 2005, following the adoption of IFRS 4 with effect from 1 January 2005. Adjusting for these items, underlying operating expenses were £639 million in 2005, £29 million or 5 per cent higher than £610 million in 2004. This underlying increase in operating expenses reflected increased business volumes and some targeted project expenditure.

The profits of the life, pensions and OEIC s business and the General insurance business are discussed further below.

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### *Life, pensions and OEICs*

The table below shows the level of new business premiums for the life and pensions business and OEIC sales. Management monitor these figures because they provide an indication of both the performance and the profitability of the business.

|                             | 2005<br>£m | 2004<br>£m |
|-----------------------------|------------|------------|
| New business and OEIC sales |            |            |
| Regular premiums            | 356        | 343        |
| Single premiums             | 3,982      | 3,141      |
| OEIC s                      |            |            |
| Regular premiums            | 33         | 33         |
| Single premiums             | 1,148      | 538        |
| Total OEIC s                | 1,181      | 571        |

Weighted sales is a UK insurance industry standard which measures the new business volumes; the weighting is made towards regular premium policies to reflect the long-term nature of these contracts. There are three main distribution channels for the sale of Lloyds TSB Group s life, pension and OEIC products and the table below shows the relative importance of each.

|   | 2005<br>£m | 2004<br>£m |
|---|------------|------------|
| Weighted sales (regular + 1/10 single): |            |            |
| Life and pensions                       | 754        | 657        |
| OEICs                                   | 148        | 86         |
| <b>Life, pensions and OEICs</b>         | <b>902</b> | <b>743</b> |
| Weighted sales by distribution channel: |            |            |
| Bancassurance                           | 274        | 242        |
| Independent financial advisers          | 562        | 432        |
| Direct                                  | 66         | 69         |
| <b>Life, pensions and OEICs</b>         | <b>902</b> | <b>743</b> |

Overall, weighted sales in 2005 increased by 21 per cent to £902 million and as a result the Lloyds TSB Group s life, pensions and investments market share increased significantly to 6.0 per cent, compared with 5.7 per cent in 2004. New business regular premiums were £13 million, or 4 per cent, higher at £356 million compared to £343 million in 2004. Strong growth in sales of pension products, as a result of more focussed marketing, more than offset lower life protection sales, resulting from the slow down in the housing market. Single premium new business sales were £841 million, or 27 per cent, higher at £3,982 million compared to £3,141 million in 2004. Single premium life sales increased, particularly the Unit Linked Flexible Options Bond product, and single premium pension sales were higher, again as a result of the specific marketing focus.

Total OEICs sales increased significantly, by £610 million to £1,181 million in 2005 compared to £571 million in 2004. Regular premium sales were little changed with the increase being in single premium sales, primarily through bancassurance; this reflects a successful campaign in relation to the April 2005 tax year end and builds on the launch of the simplified product suite that was introduced at the end of 2004.

By distribution channel, bancassurance weighted sales were £32 million, or 13 per cent, higher at £274 million compared to £242 million in 2004; this reflected, in particular, the successful OEIC sales. Weighted sales via independent financial advisers were £130 million, or 30 per cent, higher at £562 million in 2005 compared to £432 million in 2004 supported by significant product and service enhancements; as a result the Lloyds TSB Group s market share of the IFA market improved to 6.5 per cent, compared with 5.9 per cent in 2004.

Profit before tax, excluding volatility, from life, pensions and OEICs was £98 million, or 16 per cent, lower at £500 million compared to £598 million in 2004. Profitability in 2005 benefited from the absence of a provision for customer redress but the results in 2005 were reduced by a provision of £155 million for the strengthening of mortality reserves. Adjusting for these items, profit before tax, excluding volatility, in 2005 was £655 million compared to £610 million in 2004, an increase of £45 million or 7 per cent. The strong sales lead to an increased



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contribution from new business, partly offset by a commensurate increase in distribution costs. Improved investment earnings resulted from higher cash balances held for the account of the shareholder. OEICs profitability has risen following improved markets and sales volumes.

*General insurance*

|  | 2005<br>£m | 2004<br>£m |
|--|------------|------------|
| Net interest income                            | 23         | 44         |
| Other income                                   | 543        | 496        |
| <b>Total income</b>                            | <b>566</b> | 540        |
| Insurance claims                               | (197)      | (214)      |
| <b>Total income, net of insurance claims</b>   | <b>369</b> | 326        |
| Operating expenses                             | (160)      | (154)      |
| <b>Profit before tax, excluding volatility</b> | <b>209</b> | 172        |
| Volatility                                     | 28         | 8          |
| <b>Profit before tax</b>                       | <b>237</b> | 180        |

Profit before tax, excluding volatility, from the General insurance business was £209 million in 2005, which was £37 million, or 22 per cent, higher than £172 million in 2004. Net interest income was £21 million lower at £23 million, compared to £44 million in 2004, principally reflecting the adoption of IFRS 4 and IAS 39 from 1 January 2005.

|                                     | 2005<br>£m | 2004<br>£m |
|-------------------------------------|------------|------------|
| Premium income from underwriting:   |            |            |
| Creditor                            | 127        | 114        |
| Home                                | 441        | 442        |
| Health                              | 16         | 27         |
| Reinsurance premiums                | (22)       | (29)       |
|                                     | <b>562</b> | 554        |
| Commissions from insurance broking: |            |            |
| Creditor                            | 396        | 442        |
| Home                                | 49         | 45         |
| Health                              | 15         | 20         |
| Other                               | 221        | 165        |
|                                     | <b>681</b> | 672        |

Other income, was £47 million, or 9 per cent, higher at £543 million compared to £496 million in 2004; £18 million of this reflected the impact of the accounting standards applied with effect from 1 January 2005 giving an underlying increase of £29 million, or 6 per cent. Premium income from underwriting, net of reinsurance, was £8 million, or 1 per cent, higher at £562 million; creditor insurance income was higher as a result of the business written in conjunction with the Lloyds TSB Group's asset finance businesses but health premium income declined as a result of the transfer of part of this business to BUPA in 2004. Insurance broking commissions were £9 million, or 1 per cent, higher at £681 million compared to £672 million in 2004; creditor commissions were £46 million lower, as a result of a slowdown in unsecured lending growth during 2005. Other commissions, however, were £56 million higher due largely to higher levels of retrospective income on existing business.

Insurance claims, at £197 million, were £17 million, or 8 per cent, lower than £214 million in 2004. Creditor insurance payouts were lower due to a lower level of unemployment claims and home insurance claims were lower due to the relatively benign weather conditions. Health claims also fell, following the transfer of part of this business in 2004. The general insurance underwriting ratio improved to 34 per cent compared to 37 per cent in 2004.

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Operating expenses, at £160 million, were £6 million, or 4 per cent, higher than £154 million in 2004; this increase reflects higher marketing spend together with some specific project costs.

## Wholesale and International Banking

|   | 2005<br>£m   | 2004<br>£m |
|---|--------------|------------|
| Net interest income                     | 2,265        | 2,006      |
| Other income                            | 1,628        | 1,558      |
| <b>Total income</b>                     | <b>3,893</b> | 3,564      |
| Operating expenses                      | (2,181)      | (2,078)    |
| Trading surplus                         | 1,712        | 1,486      |
| Impairment losses on loans and advances | (188)        | (193)      |
| Loss on sale of businesses              | (6)          | (21)       |
| <b>Profit before tax</b>                | <b>1,518</b> | 1,272      |
| Cost:income ratio                       | 56.0%        | 58.3%      |
| Total assets (year-end) *               | £124,044m    | £123,826m  |
| Total risk-weighted assets (year-end) * | £ 80,154m    | £ 71,013m  |

\* To ensure comparability, prior year asset and risk-weighted asset figures are shown as at 1 January 2005, following implementation of those international accounting standards for which restated comparatives are not required.

Profit before tax from Wholesale and International Banking in 2005 was £246 million, or 19 per cent, higher at £1,518 million compared to £1,272 million in 2004. The overall impact of the accounting standards implemented with effect from 1 January 2005 was limited and accounted for £20 million of the increase in profits.

Net interest income was £259 million, or 13 per cent, higher at £2,265 million compared to £2,006 million in 2004. Of this increase, £100 million reflects the impact of implementation of IAS 39 from 1 January 2005 which has caused certain income previously classified as fees to be included in the effective interest rate calculation. Excluding this impact, net interest income was £159 million, or 8 per cent, higher at £2,165 million compared to £2,006 million in 2004. This underlying growth in net interest income reflected good growth in average lending balances in Corporate Banking, Structured Finance, Asset Finance and Business Banking; net interest margins were higher within Financial Markets, as a result of a change in mix of balances held, and within Structured Finance, as a result of the terms of new transactions taken on, although Corporate Banking margins reduced as a result of competitive pressures.

Other income was £70 million, or 4 per cent, higher at £1,628 million compared to £1,558 million in 2004. However, excluding the impact of the accounting standards implemented with effect from 1 January 2005, other income was £152 million, or 10 per cent, higher. This growth in underlying other income reflected increases in customer volumes within Corporate Banking, Structured Finance and Business Banking which resulted in higher lending and other fees. Business Banking also benefited from tariff reviews and from a lower level of commission clawback in respect of insurance sales; Asset Finance income increased as a result of organic growth and the impact of the motor dealerships acquired by the Lloyds TSB Group's Dutton Forshaw subsidiary during 2005.

Operating expenses were £103 million, or 5 per cent, higher at £2,181 million compared to £2,078 million in 2004. This largely reflects higher staff costs in support of the substantial business growth within Wholesale and International Banking over 2005, together with the impact of the motor dealership acquisitions.

Impairment losses on loans and advances were £5 million, or 3 per cent, lower at £188 million compared to £193 million in 2004. Charges within Corporate Banking and Structured Finance reduced by £94 million as a result of lower new provisions and a good level of recoveries in 2005, in part reflecting the benign economic environment. The impairment charge within Asset Finance was £66 million higher than in 2004 as a result of the substantial lending growth in recent years, particularly in respect of personal finance. There was also a lower level of releases within the International Banking businesses, which in 2004 had benefited from a release of £30 million from the Lloyds TSB Group's centrally held provision in respect of exposures in Argentina.

Wholesale and International Banking profit in 2005 was also reduced by a charge of £6 million in respect of the sale and closure of businesses; 2004 included a loss of £21 million which principally related to the sale of the Lloyds TSB Group's businesses in Argentina and Colombia.



**Central group items**

|   | <b>2005</b>  | 2004  |
|---|--------------|-------|
|   | <b>£m</b>    | £m    |
| Lloyds TSB Foundations                                | <b>(34)</b>  | (31)  |
| Funding cost of acquisitions less earnings on capital | <b>(380)</b> | (317) |
| Central costs and other unallocated items             | <b>(8)</b>   | (2)   |
| Loss on sale and closure of businesses                | <b>(20)</b>  |       |
| Profit before tax, excluding volatility               | <b>(442)</b> | (350) |
| Volatility  | <b>(124)</b> |       |
| Profit before tax                                     | <b>(566)</b> | (350) |

**2005 compared to 2004**

The four independent Lloyds TSB Foundations support registered charities throughout the UK that enable people, particularly the disabled and disadvantaged, to play a fuller role in society. The Foundations receive 1 per cent of the Lloyds TSB Group's pre-tax profit after adjusting for gains and losses on the disposal of businesses and pre-tax minority interests, averaged over three years, instead of a dividend on their shareholdings. In 2005, the Lloyds TSB Group accrued £34 million for payment to registered charities. See note 42 to the financial statements.

The funding cost of acquisitions, less earnings on capital, was £63 million higher at £380 million; this increase principally reflects the reclassification, as a result of the implementation of IAS 39 with effect from 1 January 2005, of certain capital instruments from minority interests to loan capital. As a result, the funding cost is now reported within interest expense.

**Volatility**

|                                   | <b>2005</b>  | 2004 |
|-----------------------------------|--------------|------|
|                                   | <b>£m</b>    | £m   |
| Banking volatility                | <b>(124)</b> |      |
| Insurance volatility              | <b>438</b>   | 168  |
| Policyholder interests volatility | <b>311</b>   | (30) |
| Total volatility                  | <b>625</b>   | 138  |

*Banking volatility*

In accordance with IFRS, it is the Lloyds TSB Group's policy to recognise all derivatives at fair value. The banking businesses manage their interest rate and other market risks primarily through the use of intra-Group derivatives, with the resulting net positions managed centrally using external derivatives. IFRS does not, however, permit the intra-Group derivatives to be used in a hedge relationship for reporting purposes. Although fair value accounting can have a significant impact on reported earnings, it does not impact on the business fundamentals or cash flows of the businesses. The Group has, therefore, implemented an internal pricing structure that allows divisions to transfer to central group items the volatility associated with marking-to-market derivatives held for risk management purposes. Banking volatility is principally comprised of the difference between the result that would be recognised on an accrual accounting basis for derivatives held for risk management purposes and their mark-to-market value. The Lloyds TSB Group has set up a central hedging function to reduce the impact of this volatility by establishing, where possible, accounting hedge relationships for the external derivatives. During 2005, profit before tax included a negative banking volatility of £124 million.

*Insurance volatility*

Changes in market variables such as the performance of equity markets and the level of interest rates, which are beyond the control of management, can result in significant volatility in the profitability of the Lloyds TSB Group's insurance businesses. As in previous years, in order to provide a clearer representation of the underlying performance of the life and pensions and general insurance businesses, the effect of these changes is separately analysed within insurance volatility. Following the implementation of the requirements of IFRS and FRS 27, insurance

volatility is principally comprised of the elements described below.

The Lloyds TSB Group's insurance businesses have substantial holdings of investments which are accounted for at fair value with changes being reflected within the income statement. The difference between the actual return on these investments attributable to shareholders and the expected return based upon economic assumptions made at the beginning of the year is included within insurance volatility. In addition, the calculation of the value of in-force business makes assumptions about future investment returns; to the extent that actual experience is different the effect is also included within insurance volatility.

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The main assumptions used in the calculation of the value of in-force business were as follows:

|  | <b>31<br/>December<br/>2005</b> | 31<br>December<br>2004 |
|--|---------------------------------|------------------------|
|  | %                               | %                      |
| Risk-adjusted discount rate (net of tax)           | <b>7.02</b>                     | 7.40                   |
| Return on equities (gross of tax)                  | <b>6.72</b>                     | 7.17                   |
| Return on fixed interest securities (gross of tax) | <b>4.12</b>                     | 4.57                   |
| Expenses inflation                                 | <b>3.79</b>                     | 3.76                   |

Changes in stock market performance also affect the realistic valuation of the guarantees and options embedded within products written in the Scottish Widows With-Profits Fund, which following the implementation of FRS 27 is now reflected on the Lloyds TSB Group's balance sheet. Fluctuations in this valuation caused by market-related movements are also included within insurance volatility. During 2005, profit before tax included positive insurance volatility of £438 million.

### *Policyholder interests volatility*

As a result of the requirement contained in IFRS to consolidate life and pensions businesses on a line-by-line basis, the Lloyds TSB Group's income statement includes amounts attributable to policyholders which affect profit before tax; the most significant of these items is policyholder tax. Under IFRS, tax on policyholder investment returns is included in the tax charge rather than being offset against the related income, either increasing or decreasing profit before tax with a corresponding change in the tax charge. In order to provide a clearer representation of the underlying performance of the Lloyds TSB Group's life and pensions businesses the impact of these items upon pre-tax profit has been separately identified within volatility. During 2005, profit before tax included positive policyholder interests volatility of £311 million.



### **Future accounting developments**

Future developments in relation to the Lloyds TSB Group's IFRS reporting are discussed in note 55 to the financial statements and future developments in relation to US GAAP are discussed in note 56 to the financial statements.

### **IFRS compared with US GAAP**

Under US GAAP, Lloyds TSB Group's net income for the year ended 31 December 2005 was £1,351 million (2004: £1,508 million) compared to £2,493 million (2004: £2,392 million) under IFRS. Reconciliations between IFRS and US GAAP figures, together with detailed explanations of the accounting differences, are included in note 56 to the financial statements.

The Lloyds TSB Group's IFRS net income increased by £101 million, or 4 per cent, in 2005 compared with 2004, whereas its US GAAP net income decreased by £157 million, or 10 per cent. The US GAAP results have been adversely affected by the Lloyds TSB Group's decision not to hedge any of its financial instruments for US GAAP accounting purposes and the increased US GAAP net pension charge.

**Hedge accounting.** Under IFRS, changes in the fair value of derivatives that are designated as hedges are either offset against the change in fair value of the hedged asset or liability through earnings or recognised directly in equity until the hedged item is recognised in earnings, depending on the nature of the hedge. Under US GAAP, because Lloyds TSB Group has elected not to satisfy the more onerous hedging criteria of SFAS No. 133 Accounting for Derivative Instruments and for Hedging Activities in respect of derivative contracts, these instruments are treated as being held for trading purposes, with the unrealised mark-to-market gains and losses taken to income as they arise and the resulting assets or liabilities recorded on the balance sheet. As Lloyds TSB Group continues to hold a significant number of derivatives which are hedge accounted under IFRS this means that net income and shareholders' equity under US GAAP are subject to greater volatility.

**Pensions.** IFRS requires that the pension costs in the income statement reflect the cost of accruing benefits for active employees, benefit improvements and the cost of severances borne by the schemes net of the expected return on scheme assets. The Lloyds TSB Group has elected to apply the corridor approach in respect of actuarial gains and losses and so, to the extent that the cumulative gains or losses remain within a corridor defined as the greater of 10 per cent of the scheme assets or liabilities, they are not reflected in the accounts. US GAAP prescribes a similar method but allows a certain portion of actuarial gains and losses to be deferred and allocated in equal amounts over the average remaining service lives of the current employees.

At the beginning of the year the cumulative unrecognised actuarial losses related to the Lloyds TSB Group's pension schemes exceeded the corridor limits on a US GAAP basis, but did not on an IFRS basis (as the relevant cumulative losses have only arisen since the adoption of IAS 19, Employee Benefits, on 1 January 2004) and consequently the 2005 US GAAP results include an amortisation charge which is not required under IFRS.

Other areas where differences in accounting have had a significant effect upon the Lloyds TSB Group's US GAAP results are as follows:

**Insurance accounting.** Under IFRS, for insurance contracts (and, in 2004, investment contracts within life assurance operations) the discounted value of the projected future cash flows attributable to the shareholder is recognised at the point of sale. IFRS therefore results in a proportion of the profit expected to accrue over the life of various products being recognised at their inception. Under US GAAP income is recognised in the income statement in the period in which it is earned and expenses in the period in which they are incurred. This results in a more even recognition of profit over the life of the related policies.

**Intangible assets.** Under US GAAP, the Lloyds TSB Group has recognised intangible assets reflecting the value of the customer relationships associated with acquisitions made in prior periods. These intangible assets are amortised through the income statement reducing US GAAP net income. The reconciling item still exists, despite the convergence of IFRS and US GAAP in this area, as, on transition, the Lloyds TSB Group chose not to apply IFRS to business combinations that occurred before 1 January 2004.

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**Average balance sheet and net interest income**

The tables below have been prepared in accordance with IFRS (for 2004 and 2005) and with UK Generally Accepted Accounting Principles (for 2003) and, as a result, the information included in the tables for 2004 and 2005 is not directly comparable with that for 2003.

| <b>IFRS</b>  | <b>2005<br/>Average<br/>balance<br/>£m</b> | <b>2005<br/>Interest<br/>income<br/>£m</b> | <b>2005<br/>Yield<br/>%</b> | <b>2004<br/>Average<br/>balance<br/>£m</b> | <b>2004<br/>Interest<br/>income<br/>£m</b> | <b>2004<br/>Yield<br/>%</b> |
|--|--|--|-----------------------------|--|--|-----------------------------|
| <b>Assets</b>  |  |  |                             |  |  |                             |
| Treasury bills and other eligible bills:   |  |  |                             |  |  |                             |
| Domestic offices   |  |  |                             | 41   | 2  | 4.88                        |
| Foreign offices  |  |  |                             | 161  | 4  | 2.48                        |
| Loans and advances to banks:   |  |  |                             |  |  |                             |
| Domestic offices   | 31,198                                     | 1,111                                      | 3.56                        | 26,731                                     | 917  | 3.43                        |
| Foreign offices  | 2,224                                      | 88   | 3.96                        | 2,071                                      | 62   | 2.99                        |
| Loans and advances to customers:   |  |  |                             |  |  |                             |
| Domestic offices   | 152,469                                    | 9,859                                      | 6.47                        | 127,646                                    | 8,221                                      | 6.44                        |
| Foreign offices  | 4,948                                      | 236  | 4.77                        | 5,514                                      | 219  | 3.97                        |
| Available-for-sale financial assets:   |  |  |                             |  |  |                             |
| Domestic offices   | 9,623                                      | 349  | 3.63                        |  |  |                             |
| Foreign offices  | 4,554                                      | 159  | 3.49                        |  |  |                             |
| Debt securities:   |  |  |                             |  |  |                             |
| Domestic offices   |  |  |                             | 9,989                                      | 300  | 3.00                        |
| Foreign offices  |  |  |                             | 4,372                                      | 118  | 2.70                        |
| Lease and hire purchase receivables:   |  |  |                             |  |  |                             |
| Domestic offices   | 11,137                                     | 787  | 7.07                        | 11,118                                     | 864  | 7.77                        |
| Foreign offices  |  |  |                             |  |  |                             |
| <b>Total interest-earning assets of banking book</b>   |  |  |                             |  |  |                             |
|  | <b>216,153</b>                             | <b>12,589</b>                              | <b>5.82</b>                 | 187,643                                    | 10,707                                     | 5.71                        |
| Total interest-earning trading securities and other financial assets at fair value through profit or loss (2004: trading assets) |  |  |                             |  |  |                             |
|  | <b>31,185</b>                              | <b>1,563</b>                               | <b>5.01</b>                 | 34,037                                     | 1,536                                      | 4.51                        |
| <b>Total interest-earning assets</b>   |  |  |                             |  |  |                             |
|  | <b>247,338</b>                             | <b>14,152</b>                              | <b>5.72</b>                 | 221,680                                    | 12,243                                     | 5.52                        |
| Allowance for impairment losses on loans and advances  |  |  |                             |  |  |                             |
|  | <b>(2,058)</b>                             |  |                             | (1,729)                                    |  |                             |
| Non-interest earning assets:   |  |  |                             |  |  |                             |
| Domestic offices   | 58,916                                     |  |                             | 47,510                                     |  |                             |
| Foreign offices  | 919  |  |                             | 902  |  |                             |
| <b>Total average assets and interest income</b>  |  |  |                             |  |  |                             |
|  | <b>305,115</b>                             | <b>14,152</b>                              | <b>4.64</b>                 | 268,363                                    | 12,243                                     | 4.56                        |
| <b>Percentage of assets applicable to foreign activities (%)</b>   |  |  |                             |  |  |                             |
|  | <b>4.2</b>                                 |  |                             | 4.8  |  |                             |

| <b>IFRS</b> | <b>2005<br/>Average<br/>interest<br/>earning<br/>assets<br/>£m</b> | <b>2005<br/>Net<br/>interest<br/>income<br/>£m</b> | <b>2005<br/>Net<br/>interest<br/>margin<br/>%</b> | <b>2004<br/>Average<br/>interest<br/>earning<br/>assets<br/>£m</b> | <b>2004<br/>Net<br/>interest<br/>income<br/>£m</b> | <b>2004<br/>Net<br/>interest<br/>margin<br/>%</b> |
|-------------|--|--|---|--|--|---|
|-------------|--|--|---|--|--|---|

Average interest-earning assets and net interest income:

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|   |                |              |             |         |       |      |
|---|----------------|--------------|-------------|---------|-------|------|
| Banking business  | <b>216,153</b> | <b>5,671</b> | <b>2.62</b> | 187,643 | 5,110 | 2.72 |
| Trading securities and other financial assets at<br>fair value through profit or loss (2004: trading<br>assets) | <b>31,185</b>  | <b>1,114</b> | <b>3.57</b> | 34,037  | 947   | 2.78 |
| <b>Net yield on interest-earning assets</b>   | <b>247,338</b> | <b>6,785</b> | <b>2.74</b> | 221,680 | 6,057 | 2.73 |

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| IFRS  | 2005<br>Average<br>balance<br>£m | 2005<br>Interest<br>expense<br>£m | 2005<br>Cost<br>% | 2004<br>Average<br>balance<br>£m | 2004<br>Interest<br>expense<br>£m | 2004<br>Cost<br>% |
|---|----------------------------------|-----------------------------------|-------------------|----------------------------------|-----------------------------------|-------------------|
| <b>Liabilities and shareholders funds</b>                             |                                  |                                   |                   |                                  |                                   |                   |
| Deposits by banks:  |                                  |                                   |                   |                                  |                                   |                   |
| Domestic offices  | 23,645                           | 854                               | 3.61              | 20,199                           | 456                               | 2.26              |
| Foreign offices   | 4,075                            | 99                                | 2.43              | 4,227                            | 102                               | 2.41              |
| Liabilities to banks under sale and repurchase agreements:            |                                  |                                   |                   |                                  |                                   |                   |
| Domestic offices  | 4,419                            | 258                               | 5.84              | 4,200                            | 192                               | 4.57              |
| Foreign offices   | 3                                |                                   | 1.56              | 4                                |                                   | 2.41              |
| Customer accounts:  |                                  |                                   |                   |                                  |                                   |                   |
| Domestic offices  | 117,622                          | 3,329                             | 2.83              | 105,400                          | 2,963                             | 2.81              |
| Foreign offices   | 2,194                            | 72                                | 3.28              | 2,303                            | 40                                | 1.74              |
| Liabilities to customers under sale and repurchase agreements:        |                                  |                                   |                   |                                  |                                   |                   |
| Domestic offices  | 4,179                            | 134                               | 3.21              | 2,787                            | 125                               | 4.49              |
| Foreign offices   | 106                              | 2                                 | 1.89              | 121                              | 2                                 | 1.65              |
| Debt securities in issue:   |                                  |                                   |                   |                                  |                                   |                   |
| Domestic offices  | 27,895                           | 1,199                             | 4.30              | 19,837                           | 924                               | 4.66              |
| Foreign offices   | 3,026                            | 108                               | 3.57              | 2,685                            | 48                                | 1.79              |
| Other interest-bearing liabilities:                                   |                                  |                                   |                   |                                  |                                   |                   |
| Domestic offices  | 3,618                            | 262                               | 7.24              | 2,635                            | 144                               | 5.46              |
| Foreign offices   |                                  |                                   |                   |                                  |                                   |                   |
| Subordinated liabilities:   |                                  |                                   |                   |                                  |                                   |                   |
| Domestic offices  | 11,515                           | 601                               | 5.22              | 10,175                           | 601                               | 5.91              |
| Foreign offices   |                                  |                                   |                   |                                  |                                   |                   |
| <b>Total interest-bearing liabilities of banking book</b>             |                                  |                                   |                   |                                  |                                   |                   |
|   | <b>202,297</b>                   | <b>6,918</b>                      | <b>3.42</b>       | 174,573                          | 5,597                             | 3.21              |
| <b>Total interest-bearing liabilities of trading book</b>             |                                  |                                   |                   |                                  |                                   |                   |
|   | <b>11,245</b>                    | <b>449</b>                        | <b>3.99</b>       | 14,992                           | 589                               | 3.93              |
| <b>Total interest-bearing liabilities</b>                             |                                  |                                   |                   |                                  |                                   |                   |
|   | <b>213,542</b>                   | <b>7,367</b>                      | <b>3.45</b>       | 189,565                          | 6,186                             | 3.26              |
| <b>Interest-free liabilities</b>                                      |                                  |                                   |                   |                                  |                                   |                   |
| Minority interests and shareholders funds:                            |                                  |                                   |                   |                                  |                                   |                   |
| Domestic offices  | 7,202                            |                                   |                   | 8,789                            |                                   |                   |
| Foreign offices   | 2,844                            |                                   |                   | 2,388                            |                                   |                   |
| Non-interest bearing customer accounts:                               |                                  |                                   |                   |                                  |                                   |                   |
| Domestic offices  | 3,636                            |                                   |                   | 3,134                            |                                   |                   |
| Foreign offices   | 267                              |                                   |                   | 372                              |                                   |                   |
| Other interest-free liabilities:                                      |                                  |                                   |                   |                                  |                                   |                   |
| Domestic offices  | 77,177                           |                                   |                   | 63,364                           |                                   |                   |
| Foreign offices   | 447                              |                                   |                   | 751                              |                                   |                   |
| <b>Total average liabilities and interest expense</b>                 |                                  |                                   |                   |                                  |                                   |                   |
|   | <b>305,115</b>                   | <b>7,367</b>                      | <b>2.41</b>       | 268,363                          | 6,186                             | 2.31              |
| <b>Percentage of liabilities applicable to foreign activities (%)</b> |                                  |                                   |                   |                                  |                                   |                   |
|   | <b>3.4</b>                       |                                   |                   | 4.1                              |                                   |                   |
| <b>IFRS</b>   |                                  |                                   |                   |                                  |                                   |                   |
|   |                                  |                                   | <b>2005</b>       |                                  |                                   | <b>2004</b>       |
|   |                                  |                                   | %                 |                                  |                                   | %                 |
| <b>Net interest margin for the banking book</b>                       |                                  |                                   |                   |                                  |                                   |                   |

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|                  |             |      |
|------------------|-------------|------|
| Domestic offices | <b>2.68</b> | 2.79 |
| Foreign offices  | <b>1.72</b> | 1.74 |
| Group margin     | <b>2.62</b> | 2.72 |

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Loans and advances to banks and customers include impaired lending. In 2004, interest receivable on such loans was only included to the extent to which cash payments had been received, in accordance with Lloyds TSB Group's policy on income recognition. In 2005, interest has been recognised using the effective interest rate method, as required by IAS 39.

Approximately 85 per cent of the value of the balances are calculated on a daily basis with balances held by Lloyds TSB Group's leasing and asset finance businesses averaged on a monthly basis. Management believes that the interest rate trends are substantially the same as they would be if all balances were averaged on the same basis.

**Changes in net interest income volume and rate analysis**

The following table allocates changes in net interest income between volume and rate for 2005 compared with 2004. Where variances have arisen from both changes in volume and rate these are allocated to volume.

| IFRS  | 2005 compared with 2004<br>Increase/(decrease) |              | Rate<br>£m |
|---|--|--------------|------------|
|   | Total change<br>£m                             | Volume<br>£m |            |
| <b>Interest receivable and similar income</b>   |  |              |            |
| Loans and advances to banks:  |  |              |            |
| Domestic offices  | 194  | 159          | 35         |
| Foreign offices   | 26   | 6            | 20         |
| Loans and advances to customers:  |  |              |            |
| Domestic offices  | 1,638  | 1,605        | 33         |
| Foreign offices   | 17   | (27)         | 44         |
| Available-for-sale financial assets (2004: Treasury and other eligible bills and Debt securities):  |  |              |            |
| Domestic offices  | 47   | (15)         | 62         |
| Foreign offices   | 37   | 1            | 36         |
| Lease and hire purchase receivables:  |  |              |            |
| Domestic offices  | (77)   | 1            | (78)       |
| Foreign offices   |  |              |            |
| <hr/>   |  |              |            |
| Total banking book interest receivable and similar income   | 1,882  | 1,730        | 152        |
| Total interest receivable and similar income on trading securities and other financial assets at fair value through profit or loss (2004: trading assets) | 27   | (143)        | 170        |
| <hr/>   |  |              |            |
| <b>Total interest receivable and similar income</b>   | <b>1,909</b>                                   | <b>1,587</b> | <b>322</b> |

| IFRS   | 2005 compared with 2004<br>Increase/(decrease) |              | Rate<br>£m |
|--|--|--------------|------------|
|  | Total change<br>£m                             | Volume<br>£m |            |
| <b>Interest payable</b>  |  |              |            |
| Deposits by banks:   |  |              |            |
| Domestic offices   | 398  | 124          | 274        |
| Foreign offices  | (3)  | (4)          | 1          |
| Liabilities to banks under sale and repurchase agreements:     |  |              |            |
| Domestic offices   | 66   | 13           | 53         |
| Foreign offices  |  |              |            |
| Customer accounts:   |  |              |            |
| Domestic offices   | 366  | 346          | 20         |
| Foreign offices  | 32   | (4)          | 36         |
| Liabilities to customers under sale and repurchase agreements: |  |              |            |
| Domestic offices   | 9  | 45           | (36)       |
| Foreign offices  |  |              |            |
| Debt securities in issue:                                      |  |              |            |
| Domestic offices   | 275  | 346          | (71)       |
| Foreign offices  | 60   | 12           | 48         |
| Other interest bearing liabilities:                            |  |              |            |
| Domestic offices   | 118  | 71           | 47         |
| Foreign offices  |  |              |            |
| Subordinated liabilities:                                      |  |              |            |
| Domestic offices   |  | 70           | (70)       |

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Foreign offices

|                                     |              |            |            |
|-------------------------------------|--------------|------------|------------|
| Total banking book interest payable | 1,321        | 1,019      | 302        |
| Total trading book interest payable | (140)        | (150)      | 10         |
| <b>Total interest payable</b>       | <b>1,181</b> | <b>869</b> | <b>312</b> |

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The average balance sheet for 2003 excludes the long-term assurance business assets and liabilities attributable to policyholders. The interest yields and costs for foreign office assets and liabilities have been affected by Lloyds TSB Group's operations in Latin America since the countries in which Lloyds TSB Group has operated are periodically subject to comparatively high rates of interest, in certain instances this has had the effect of producing unusually high yields and costs.

| UK GAAP  | 2003<br>Average<br>balance<br>£m | 2003<br>Interest<br>income<br>£m | 2003<br>Yield<br>% |
|--|----------------------------------|----------------------------------|--------------------|
| <b>Assets</b>  |                                  |                                  |                    |
| Treasury bills and other eligible bills:                         |                                  |                                  |                    |
| Domestic offices   | 2,237                            | 68                               | 3.04               |
| Foreign offices  | 541                              | 5                                | 0.92               |
| Loans and advances to banks:                                     |                                  |                                  |                    |
| Domestic offices   | 11,831                           | 412                              | 3.48               |
| Foreign offices  | 2,487                            | 117                              | 4.70               |
| Loans and advances to customers:                                 |                                  |                                  |                    |
| Domestic offices   | 111,340                          | 6,877                            | 6.18               |
| Foreign offices  | 18,491                           | 1,434                            | 7.76               |
| Debt securities:   |                                  |                                  |                    |
| Domestic offices   | 9,863                            | 350                              | 3.55               |
| Foreign offices  | 4,664                            | 102                              | 2.19               |
| Lease and hire purchase receivables:                             |                                  |                                  |                    |
| Domestic offices   | 11,429                           | 783                              | 6.85               |
| Foreign offices  | 13                               | 1                                | 7.69               |
| <hr/>  |                                  |                                  |                    |
| Total interest-earning assets of banking book                    | 172,896                          | 10,149                           | 5.87               |
| Total interest-earning assets of trading book                    | 17,622                           | 666                              | 3.78               |
| <hr/>  |                                  |                                  |                    |
| <b>Total interest-earning assets</b>                             | <b>190,518</b>                   | <b>10,815</b>                    | <b>5.68</b>        |
| Provisions for bad and doubtful debts                            | (1,846)                          |                                  |                    |
| Non-interest earning assets:                                     |                                  |                                  |                    |
| Domestic offices   | 18,973                           |                                  |                    |
| Foreign offices  | 3,353                            |                                  |                    |
| <hr/>  |                                  |                                  |                    |
| <b>Total average assets and interest income</b>                  | <b>210,998</b>                   | <b>10,815</b>                    | <b>5.13</b>        |
| <hr/>  |                                  |                                  |                    |
| <b>Percentage of assets applicable to foreign activities (%)</b> | <b>13.8</b>                      |                                  |                    |
| <hr/>  |                                  |                                  |                    |

| UK GAAP  | 2003<br>Average<br>interest<br>earning<br>assets<br>£m | 2003<br>Net<br>interest<br>income<br>£m | 2003<br>Yield<br>% |
|--|--|---|--------------------|
| Average interest-earning assets and net interest income: |  |   |                    |
| Banking business   | 172,896  | 5,255                                   | 3.04               |
| Trading business   | 17,622   |   |                    |
| <hr/>  |  |   |                    |
| <b>Net yield on interest-earning assets</b>              | <b>190,518</b>   | <b>5,255</b>                            | <b>2.76</b>        |
| <hr/>  |  |   |                    |



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| UK GAAP   | 2003<br>Average<br>balance<br>£m | 2003<br>Interest<br>expense<br>£m | 2003<br>Cost<br>% |
|---|----------------------------------|-----------------------------------|-------------------|
| <b>Liabilities and shareholders funds</b>                             |                                  |                                   |                   |
| Deposits by banks:  |                                  |                                   |                   |
| Domestic offices  | 13,610                           | 259                               | 1.90              |
| Foreign offices   | 5,333                            | 113                               | 2.12              |
| Liabilities to banks under sale and repurchase agreements:            |                                  |                                   |                   |
| Domestic offices  | 1,449                            | 29                                | 2.00              |
| Foreign offices   | 253                              | 37                                | 14.62             |
| Customer accounts:  |                                  |                                   |                   |
| Domestic offices  | 97,864                           | 2,282                             | 2.33              |
| Foreign offices   | 8,637                            | 450                               | 5.21              |
| Liabilities to customers under sale and repurchase agreements:        |                                  |                                   |                   |
| Domestic offices  | 2,990                            | 148                               | 4.95              |
| Foreign offices   | 156                              | 3                                 | 1.92              |
| Debt securities in issue:   |                                  |                                   |                   |
| Domestic offices  | 16,793                           | 606                               | 3.61              |
| Foreign offices   | 7,959                            | 345                               | 4.33              |
| Subordinated liabilities:   |                                  |                                   |                   |
| Domestic offices  | 10,371                           | 610                               | 5.88              |
| Foreign offices   | 198                              | 12                                | 6.06              |
| <hr/>   |                                  |                                   |                   |
| Total interest-bearing liabilities of banking book                    | 165,613                          | 4,894                             | 2.96              |
| Total interest-bearing liabilities of trading book                    | 17,622                           | 666                               | 3.78              |
| <hr/>   |                                  |                                   |                   |
| <b>Total interest-bearing liabilities</b>                             | <b>183,235</b>                   | <b>5,560</b>                      | <b>3.03</b>       |
| <b>Interest-free liabilities</b>                                      |                                  |                                   |                   |
| Minority interests and shareholders funds:                            |                                  |                                   |                   |
| Domestic offices  | 6,133                            |                                   |                   |
| Foreign offices   | 3,064                            |                                   |                   |
| Non-interest bearing customer accounts:                               |                                  |                                   |                   |
| Domestic offices  | 2,745                            |                                   |                   |
| Foreign offices   | 845                              |                                   |                   |
| Other interest-free liabilities:                                      |                                  |                                   |                   |
| Domestic offices  | 12,282                           |                                   |                   |
| Foreign offices   | 2,694                            |                                   |                   |
| <hr/>   |                                  |                                   |                   |
| <b>Total average liabilities and interest expense</b>                 | <b>210,998</b>                   | <b>5,560</b>                      | <b>2.64</b>       |
| <hr/>   |                                  |                                   |                   |
| <b>Percentage of liabilities applicable to foreign activities (%)</b> | <b>12.9</b>                      |                                   |                   |
| <hr/>   |                                  |                                   |                   |

| UK GAAP   | 2003<br>% |
|---|-----------|
| <b>Net interest margin for the banking book</b> |           |
| Domestic offices                                | 3.11      |
| Foreign offices                                 | 2.67      |
| Group margin                                    | 3.04      |

## **Risk management**

### **Risk as a strategic differentiator**

Following the embedding of the risk governance framework and the repositioning of specialist risk functions closer to the business in 2004, the focus for 2005 has been the development of a new risk framework which clearly aligns our risk taking to the objectives and priorities of Lloyds TSB Group and facilitates more effective decision making. The Group's ability to take risks which are well understood, consistent with our strategy and plans and appropriately remunerated, is a key driver of shareholder return.

The maintenance of a strong control framework remains a priority and is the foundation for the delivery of effective risk management. Risk analysis and reporting have been further strengthened to identify opportunities as well as risks, to improve the Group's ability to take an aggregate view of the overall risk portfolio and assign clear responsibilities and timescales at group and divisional level for risk mitigation strategies. Risk continues to be a key component of routine management information reporting and is embedded within staff objectives via balanced scorecards.

The objective remains to go beyond risk mitigation and control to developing risk capabilities as a key strategic differentiator for Lloyds TSB.

Regulatory requirements

Risk control

Defining and promoting  
effective use of the  
Group's risk capacity

Differentiating excellence  
in risk management

Effectiveness

### **Risk governance structures**

The changing regulatory environment faced by the Group's businesses, and developments in best practice, prompted the Group during 2003 and 2004 to perform an extensive review of its risk governance structures. During 2005 these structures have enabled the Group to strengthen risk evaluation and management.

**Board and committees**

**Risk management oversight**

**Business risk management**

Board and board committees

Management committees

Personnel

Functions

Direct reporting line

Functional reporting line to support committees

Functional reporting line

Business risk functions report to their respective managing director, who in turn reports to the group executive directors

Audit committee

Risk oversight committee

Group executive committee

Group chief executive

Group executive directors

Divisional risk officers

Director of group audit

Group Risk

Chief risk director

Business risk functions\*

Group asset and liability  
committee

Group business risk  
committee

Lloyds TSB board

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The board, assisted by its sub-committees, the risk oversight committee, the group executive committee and the audit committee approves the Group's overall risk management framework. The board also reviews the Group's aggregate risk exposures and concentrations of risk to seek to ensure that these are consistent with the board's appetite for risk. The risk oversight responsibilities of the board, audit committee and risk oversight committee are shown in the corporate governance section (see Management and employees Corporate governance ) and further key risk oversight roles are described below.

The group executive committee, assisted by its sub-committees the group business risk committee and the group asset and liability committee, supports the group chief executive in ensuring the development, implementation and effectiveness of the Group's risk management framework and the clear articulation of the Group's risk policies, and reviews the Group's aggregate risk exposures and concentrations of risk. The group executive committee's duties are described more fully on page 92.

Directors of the Group's businesses have primary responsibility for measuring, monitoring and controlling risks within their areas of accountability and are required to establish control frameworks for their businesses that are consistent with the Group's high level policies and within the parameters set by the board, group executive committee and Group Risk. Compliance with policies and parameters is overseen by the risk oversight committee, the group business risk committee, the group asset and liability committee, Group Risk and the divisional risk officers.

The chief risk director, a member of the group executive committee and reporting directly to the group chief executive, oversees and promotes the development and implementation of a consistent group wide risk management framework. The chief risk director, supported by Group Risk, provides objective challenge to the Group's senior management.

Divisional risk officers provide oversight of risk management activity within each of the Group's operating divisions. Reporting directly to the group executive directors responsible for the divisions and the chief risk director, their day-to-day contact with business management, business operations and risk initiatives seeks to provide an effective risk oversight mechanism. The direct reporting line to the chief risk director enables the Group to maintain a wide ranging and current perspective on material risks facing the Group and provides a mechanism to share best risk management practice.

The director of group audit provides the required independent assurance to the audit committee and the board that risks within the Group are recognised, monitored and managed within acceptable parameters. Group Audit is fully independent of Group Risk, seeking to ensure objective challenge to the effectiveness of the risk governance framework.

Accountability of line management has been further reinforced in relation to the management of risks arising from the Group's business and in developing the risk awareness and risk management capability of the Group's staff. A key objective is to ensure that business decisions strike an appropriate balance between risk and reward, consistent with the Group's risk appetite. The top management team received regular briefings and guidance from the chief risk director to ensure awareness of the overarching risk model and a clear understanding of their accountabilities for risk and internal control.

During the year a new Control Self Assessment process has increased the focus of management at all levels on risk management and reinforced accountabilities. All business units, divisional risk offices and group functions have completed a Control Self Assessment, reviewing the effectiveness of their internal controls and putting in place enhancements where appropriate. Managing directors and group executive directors have certified the accuracy of their assessment.

Business management forms part of a tiered risk management model, as shown on page 36, with the divisional risk officers providing oversight and challenge, as described above, and the chief risk director and group committees establishing the group wide perspective.

The model seeks to provide the Group with an effective mechanism for developing and embedding risk policies and risk management strategies which are aligned with the risks faced by its businesses. It also facilitates effective communication on these matters across the Group. These arrangements enable the Group to anticipate and pre-empt risks better, and to manage more effectively those risks which crystallise.

Reflecting the importance the Group places on risk management, risk is one of the five principal criteria that it includes in its balanced scorecard on which individual staff performance is judged. Business executives have specified risk management objectives, and incentive schemes take account of performance against these.

### **Risk management framework**

Lloyds TSB Group uses an enterprise-wide framework for the identification, assessment, measurement and management of risk, designed to meet its customers' needs and maximise value for shareholders over time by aligning risk management with the corporate strategy; assessing the impact of emerging risks from new technologies or markets; and developing risk tolerances and mitigating strategies. The framework strengthens the Group's ability to identify and assess risks; aggregate group-wide risks and define the corporate risk appetite; develop solutions for reducing or transferring risk, where appropriate; and exploit risks to gain competitive advantage, thereby seeking to increase shareholder

value.

A key focus for 2005 has been the enhancement of this framework. The approach starts with a simple but clear articulation of the Group's strategic vision and the desired outcomes for our key stakeholders (shareholders, customers, staff, debt holders and regulators). The risk implications are expressed in a risk vision and high level risk appetite measures, which are in turn translated into high level risk principles and risk appetite measures and metrics for the primary risk types (credit risk, market risk, insurance risk, operational risk, strategy risk and financial soundness). The degree of sophistication continues to evolve. An overview of each of the primary risk drivers is set out on pages 39 to 60. The more detailed articulation of the risk principles and distribution of the risk appetite measures amongst the divisions and businesses is subsequently agreed by the group chief executive, through consultation with the group executive committee and on the advice of the group business risk committee and the group asset and liability committee.

**Risk language**

The Group has revised the risk language during the year such that all risks are classified within one of six primary risk drivers. These are further broken down into thirteen enterprise wide risk management (EWRM) risk types to enable more detailed review and facilitate appropriate reporting and analysis of root causes, as set out below.

**Primary risk  
drivers**

**EWRM  
risk types**

**Strategy**

Strategy

**Credit**

Credit

**Market**

Market

**Insurance**

Insurance

**Operational**

**Financial soundness**

Financial soundness

Governance

Legal and regulatory

Customer treatment

Process and resource

Theft, fraud and  
other criminal acts

People

Change

Product and service

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Governance risk, legal and regulatory risk, customer treatment risk, process and resource risk, theft, fraud and other criminal acts risk, people risk and change-related risk are all categories of operational risk. A more detailed language has been identified for these operational risks.

### **Risk policy**

A key component of the risk management framework is the policy framework. During the year this has been substantially revised to reinforce clarity of accountabilities, efficiency and effectiveness. The process of embedding will continue into 2006.

The main policy levels are identified below:

Principles high level policy for the six primary risk drivers (agreed by the board)

Group policy policy for the main EWRM risk types aligned to the risk drivers (agreed by the group chief executive)

Detailed group policy detailed policy that applies across the Group (agreed by the chief risk director)

Divisional policy local policy that specifically applies to a division (agreed by the appropriate group risk director)

Business unit policy local policy that specifically applies to a business unit (agreed by the divisional risk officer)

Divisional and business unit policy is only produced by exception and is not necessary unless there is a specific area for which a particular division or business unit requires a greater level of detail than is appropriate for group level policy. The governance arrangements for development of, and compliance with, group, divisional and business unit policy, and the associated accountabilities are clearly outlined. All staff are expected to be aware of the policies and procedures which apply to them and their work and to observe the relevant policies and procedures. Line management in each business area has primary responsibility for ensuring that group policies and the relevant local policies and procedures are known and observed by all staff within that area.

Group and divisional risk functions have responsibility for overseeing effective implementation of policy. Group Audit provides independent assurance to the board about the effectiveness of the Group's control framework and adherence to policy.

Policies are reviewed regularly to seek to ensure accuracy and appropriateness.

### **Risk reporting**

Divisional risk functions use the standard language when reporting risks centrally, to enable risk aggregation, and when assessing risk levels of new products, change initiatives or business plans. Divisional risk committees monitor their risk levels against their risk appetite seeking to ensure effective mitigating action is being taken where appropriate. Divisional risk reports are reviewed by divisional executive committees to ensure divisional senior management are satisfied with the overall risk profile, risk accountabilities and progress on any necessary mitigating actions.

At group level a consolidated risk report is produced which is reviewed and debated by group business risk committee, group executive committee, risk oversight committee and board to ensure senior management and the board are satisfied with the overall risk profile, risk accountabilities and any necessary mitigating actions. During the year the Group's consolidated risk report was further enhanced to support the identification, control and effective management of risk.

## **Strategy risk**

The Group includes product and service risk within the wider definition of strategy risk and the two categories are described in further detail below.

### **Strategy risk**

#### ***Definition***

Strategy risk is the risk arising from developing a strategy that does not maximise franchise value and/or fails to achieve the initiatives in the agreed strategic plan due to changing or flawed assumptions. In assessing strategic risk consideration is given to both:

external factors (i.e. economic, technological, political, social and ethical, environmental, legal and regulatory, market expectations, reputation and competitive behaviour), and

internal factors (i.e. resource capability and availability, customer treatment, service level agreements, products and funding and the risk appetite of other risk categories).

#### ***Control***

An annual strategic planning process is conducted at group and business level which includes a quantitative and qualitative assessment of the risks in the Group's plan. Within the planning round, the Group conducts both scenario analysis and stress tests to assess risks to future earnings streams.

The Group's strategy is reviewed and approved by the board. Regular reports are provided to the group executive committee and the board on the progress of the Group's key strategies and plans. Group Risk conducts oversight to seek to ensure the business plans remain consistent with the Group's strategy. Revenue and capital investment decisions require additional formal assessment and approval. Formal risk assessment is conducted as part of the financial approval process. Significant company mergers and acquisitions require specific approval by the board. In addition to the standard due diligence conducted during a merger or acquisition, Group Risk conducts, where appropriate, an independent risk assessment of the target company and its proposed integration into Lloyds TSB Group.

A common approach is applied across the Group to assess the creation of shareholder value. This is measured by economic profit (the profit attributable to shareholders, less a notional charge for the equity invested in the business). The focus on economic profit allows the Group to compare the returns being made on capital employed in each business. The use of risk-based economic capital and regulatory capital is closely monitored at business and group level. The Group's economic capital model covers credit, market, insurance, business and operational risks.

## **Product and service risk**

#### ***Definition***

The risk of reductions in earnings and/or value, through financial or reputational loss, from the inherent characteristics, management or distribution of products or services, or from failure to meet or better customer expectations and competitor offerings.

#### ***Control***

The Group is strongly committed to the fair treatment of its customers. This is embedded into the processes and risk assessment which takes place to seek to ensure businesses have developed customer centric strategies for product and business development, marketing, selling and after sales service. Businesses maintain a range of products to meet customers' needs and the business strategy and are responsible for managing and controlling product risks and complying with applicable regulations.

Businesses have formal processes for reviewing the range of their product portfolios and subject all product development to rigorous assessment. The assessment includes seeking to ensure that the product meets clearly defined customer needs. Businesses have a defined channel distribution strategy for products, consistent with the Group's distribution strategy. Businesses launching new products are responsible for ensuring compliance with all applicable regulations and that the proposed sales activity is appropriate for the type of customer and their attitude to risk.

The Group defines a new product as a new or amended product that introduces a significantly different risk profile at group or business level. In line with defined policy, businesses provide divisional risk management with details of new products at an early stage of product or service development to seek to ensure compliance with the Group's risk appetite and strategy. Businesses are required to demonstrate that new products meet clearly defined customer needs and that the sales process mitigates the risks of unsuitable sales. Where appropriate, technical advice and



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approval is sought from specialist functions. Only new products carrying the approval of divisional risk management and the businesses involved in their manufacture and delivery are offered to customers.

Businesses establish and monitor performance standards for all marketed products across a range of indicators, for example sales volumes, customer service and risk profile. Significant deviations from these standards are investigated and appropriate action taken.

## **Credit risk**

### ***Definition***

The risk of reductions in earnings and/or value, through financial or reputational loss, as a result of the failure of the party with whom we have contracted to meet its obligations (both on and off balance sheet).

### ***Credit risk framework***

Credit risk is managed according to baseline credit framework standards, against which all activity is assessed. This framework identifies the following key elements: governance, organisational framework, policies, people, processes and procedures, management information, and systems and technology.

Credit risk can arise from lending or investing or through off balance sheet activities such as guarantees or the undertaking of settlement or delivery risk. The primary off balance sheet instruments used by the Group are guarantees together with standby, documentary and commercial letters of credit.

In its principal retail portfolios, the Group uses statistically-based decisioning techniques (primarily credit scoring), although thresholds are set above which an individual credit assessment takes place. Divisional risk departments review scorecard effectiveness and approve changes, with material changes subject to Group Risk approval. Credit risk in non-retail portfolios is subject to individual credit assessments, which consider the strengths and weaknesses of individual transactions and the balance of risk and reward.

Credit risk exposures in the insurance businesses arise primarily from holding investments and from exposure to reinsurers. Control is exercised over those exposures through a suitable combination of formal limits set out in mandates, credit policy parameters and high level committee oversight.

Credit risk also arises from the use of derivatives. Note 17 to the financial statements shows the total notional principal amount of interest rate, exchange rate and equity and other contracts outstanding at 31 December 2005. The notional principal amount does not, however, represent the Group's credit risk exposure, which is limited to the current cost of replacing contracts with a positive value to the Group. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure.

Credit risk may also arise through the existence of contracts for the provision of services or products to Lloyds TSB and this is also considered through individual credit assessments, where the risks of loss are material.

Day-to-day credit management and asset quality within each business is primarily the responsibility of the relevant business director.

Credit quality is supported by specialist units to provide, for example: intensive management and control; security perfection, maintenance and retention; expertise in documentation for lending and associated products; sector-specific expertise; and legal services applicable to the particular market place and product range offered by the business.

Impairment provisions are provided for losses that have been incurred at the balance sheet date. Changes in general economic conditions in the UK or in interest rates could result in losses that are different from those provided for at the balance sheet date.

### ***Control***

The following are the principal mechanisms through which the Group operates the credit risk framework set out above:

*Credit rating systems.* All business units operate appropriate rating system(s) for their portfolio(s). All rating systems, which are authorised by executive management, comply with the Group's standard methodology. The Group uses a 'Master Scale' rating structure with ratings corresponding to a range of probabilities of future default.

*Monitoring of rating systems.* The Group uses rating systems as an integral part of the credit process deployed within the credit life cycle. Whilst divisional risk teams have responsibility for monitoring rating model performance, Group Risk reviews new models and material changes to existing models, seeking executive management approval as necessary.

*Portfolio monitoring and reporting.* With Group Risk, businesses and divisions identify and define portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposure. This entails the production and analysis of regular portfolio monitoring reports for review by Group Risk. Group Risk in turn produces an aggregated review of

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credit risk throughout the Group, which is presented to the group business risk committee.

*Credit principles and policy.* Group Risk sets out the group credit principles according to which credit risk is managed. These form the basis of the group credit policy, which in turn is the basis for divisional and business unit credit policy. Principles and policy are reviewed regularly and any changes are subject to a review and approval process.

*Lending guidelines.* These define the responsibilities of lending officers and seek to provide a disciplined and focused benchmark for credit decisions.

*Counterparty limits.* Exposure to individual counterparties, groups of counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature and term of the risk. Regular reports on significant credit exposures are provided to the group executive committee and board.

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*Cross-border and cross-currency exposures.* Country limits are authorised and managed by a dedicated unit taking into account economic and political factors.

*Concentration risk.* Credit risk management sets portfolio controls on certain industries, sectors and product lines that reflect risk appetite, and monitors exposures to prevent excessive concentration of risk. These concentration risk controls are not necessarily in the form of a maximum limit on lending but may instead require new business in concentrated sectors to fulfil additional hurdle requirements. Amongst these controls is a series of time-referenced sector caps to manage residual value risk exposure, seeking to ensure an acceptable distribution of risk. The Group's large exposures are managed in accordance with regulatory reporting requirements.

*Impairment process.* The maintenance of adequate impairment allowances is considered a key issue from a credit control perspective. Impairment methodology is set out in credit policy and is subject to a rigorous governance process, including the preparation of a regular Impairment Review paper to executive management, consideration by dedicated business unit and divisional impairment review committees and the reporting to the group executive committee of material individual counterparty impairment charges.

*Facilities database.* A database is maintained of all non-retail customer relationships to assist in the identification and aggregation of cross-business unit commitments. The Group uses a system known as parent company executives, under which there is a central person responsible for each non-retail customer relationship, to whom other business units wishing to do business with the same customer must apply for credit limits.

*Credit portfolio model.* The Group models portfolio credit risk based on defaults, using a statistically-based model which calculates the economic equity employed and credit value at risk for each portfolio.

Stress testing and scenario analysis. The credit portfolio model is also used in stress-testing, to simulate a scenario and calculate its impact. Our modelling capabilities are currently subject to further development. Events are modelled both at a group wide level, at divisional and business unit level and by portfolio, for example, for a specific industry sector.

*Risk assurance and oversight.* Divisional and group level oversight teams monitor credit performance trends, review and challenge exceptions to planned outcomes and test the adequacy of credit risk infrastructure and governance processes throughout the Group. This includes tracking portfolio performance against an agreed set of key risk indicators. Risk assurance teams and Group Audit are engaged where appropriate to conduct further credit reviews if a need for closer scrutiny is identified.

### ***Risk appetite***

Credit risk appetite is defined as the quantum and quality of the desired credit portfolio and the direction in which the Group wants to manage it, in order to achieve its short and long-term strategic goals.

Historically, credit risk appetite has been described through a series of policies, sector caps, country limits and the annual and planned bad debt charge. To supplement this, and provide a more forward looking view of credit risk, we have now embarked on the process of introducing more sophisticated metrics to define credit risk appetite, assisted by the introduction of more advanced rating systems across the Group to support Basel II developments. A number of different measures have been developed to describe the Group's credit risk appetite, since no single measure is considered sufficient. These metrics will be used as the basis for setting appetite ranges, at business unit, division and aggregated group level.

These appetite ranges will not replace the existing controls and measures set out above. It is expected that our appetite measures will be improved over time as usage is widened and methodologies developed.

### ***Risk mitigation***

Lloyds TSB Group uses a range of approaches to mitigate credit risk. In the case of individual exposures, the Group makes use of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. The Group will also consider the sale of assets, where credit concerns exist. Securitisation is another credit mitigation technique which receives consideration as does the use of credit derivative-based approaches.

Where it is efficient and likely to be effective (generally with counterparties with which it undertakes a significant volume of transactions), the Group enters into master netting arrangements. Although master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis, they do reduce the credit risk to the extent that if an event of default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Group's overall exposure to credit risk on derivative instruments subject to master netting arrangements can change substantially within a short period since it is affected by each transaction subject to the arrangement.



**Loan portfolio**

The tables below have been prepared in accordance with IFRS (for 2004 and 2005) and with UK Generally Accepted Accounting Principles (for 2001, 2002 and 2003) and, as a result, the information included in the tables for 2004 and 2005 is not directly comparable with that for 2001, 2002 and 2003.

**Analysis of loans and advances to banks and customers**

The following tables analyse loans to banks and customers by geographical area and type of loan at 31 December for each of the five years listed.

| <b>IFRS</b>  | <b>2005</b><br><b>£m</b> | 2004<br>£m |
|--|--------------------------|------------|
| <b>Domestic</b>  |                          |            |
| Loans and advances to banks  | <b>28,859</b>            | 29,052     |
| Loans and advances to customers:                                       |                          |            |
| Mortgages  | <b>88,528</b>            | 80,065     |
| Other personal lending   | <b>22,776</b>            | 22,830     |
| Agriculture, forestry and fishing                                      | <b>2,299</b>             | 2,076      |
| Manufacturing  | <b>5,983</b>             | 3,292      |
| Construction   | <b>2,059</b>             | 1,877      |
| Transport, distribution and hotels                                     | <b>7,649</b>             | 6,753      |
| Financial, business and other services                                 | <b>16,272</b>            | 13,442     |
| Property companies   | <b>8,267</b>             | 5,775      |
| Lease financing  | <b>5,815</b>             | 6,227      |
| Hire purchase  | <b>4,853</b>             | 4,828      |
| Other  | <b>7,696</b>             | 5,223      |
| <b>Total domestic loans</b>  | <b>201,056</b>           | 181,440    |
| <b>Foreign</b>   |                          |            |
| Loans and advances to banks  | <b>2,797</b>             | 2,797      |
| Loans and advances to customers:                                       |                          |            |
| Mortgages  | <b>367</b>               | 277        |
| Other personal lending   | <b>260</b>               | 256        |
| Agriculture, forestry and fishing                                      | <b>46</b>                | 31         |
| Manufacturing  | <b>795</b>               | 511        |
| Construction   | <b>130</b>               | 87         |
| Transport, distribution and hotels                                     | <b>730</b>               | 1,041      |
| Financial, business and other services                                 | <b>1,586</b>             | 1,763      |
| Property companies   | <b>142</b>               | 64         |
| Other  | <b>763</b>               | 583        |
| <b>Total foreign loans</b>   | <b>7,616</b>             | 7,410      |
| <b>Total loans</b>   | <b>208,672</b>           | 188,850    |
| Allowance for impairment losses  | <b>(2,073)</b>           | (1,663)    |
| Interest held in suspense  | <b>(21)</b>              | (21)       |
| <b>Total loans and advances net of allowance for impairment losses</b> | <b>206,599</b>           | 187,166    |

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| UK GAAP   | 2003<br>£m     | 2002<br>£m     | 2001<br>£m     |
|---|----------------|----------------|----------------|
| <b>Domestic</b>   |                |                |                |
| Loans and advances to banks   | 13,671         | 15,291         | 12,737         |
| Loans and advances to customers:  |                |                |                |
| Mortgages   | 70,750         | 62,467         | 56,578         |
| Other personal lending  | 20,139         | 16,579         | 13,765         |
| Agriculture, forestry and fishing   | 2,025          | 2,076          | 2,074          |
| Manufacturing   | 3,211          | 3,373          | 3,321          |
| Construction  | 1,497          | 1,482          | 1,309          |
| Transport, distribution and hotels  | 4,741          | 4,696          | 4,440          |
| Financial, business and other services  | 9,652          | 8,352          | 8,736          |
| Property companies  | 4,577          | 4,008          | 2,907          |
| Lease financing   | 6,470          | 7,285          | 7,552          |
| Hire purchase   | 4,701          | 4,342          | 4,364          |
| Other   | 3,351          | 3,397          | 2,992          |
| <b>Total domestic loans</b>   | <b>144,785</b> | <b>133,348</b> | <b>120,775</b> |
| <b>Foreign</b>  |                |                |                |
| Loans and advances to banks   | 1,894          | 2,239          | 2,489          |
| Loans and advances to customers:  |                |                |                |
| Mortgages   | 331            | 4,763          | 3,467          |
| Other personal lending  | 263            | 1,098          | 1,672          |
| Agriculture, forestry and fishing   | 40             | 2,220          | 1,708          |
| Manufacturing   | 926            | 1,608          | 2,004          |
| Construction  | 124            | 328            | 304            |
| Transport, distribution and hotels  | 1,423          | 2,459          | 2,570          |
| Financial, business and other services  | 1,866          | 3,196          | 2,631          |
| Property companies  | 74             | 1,117          | 896            |
| Lease financing   |                | 15             | 33             |
| Other   | 795            | 1,436          | 1,148          |
| <b>Total foreign loans</b>  | <b>7,736</b>   | <b>20,479</b>  | <b>18,922</b>  |
| <b>Total loans</b>  | <b>152,521</b> | <b>153,827</b> | <b>139,697</b> |
| Provisions for loan losses  | (1,695)        | (1,767)        | (1,468)        |
| Interest held in suspense   | (28)           | (57)           | (70)           |
| <b>Total loans and advances net of provisions and interest held in suspense</b> | <b>150,798</b> | <b>152,003</b> | <b>138,159</b> |

| IFRS                                       | 2005<br>£m   | 2004<br>£m   |
|--|--------------|--------------|
| <b>Analysis of foreign loans by region</b> |              |              |
| Loans and advances to customers:           |              |              |
| Latin America                              | 173          | 125          |
| USA  | 1,984        | 2,385        |
| Europe                                     | 1,927        | 1,587        |
| Rest of the world                          | 735          | 516          |
|  | <b>4,819</b> | <b>4,613</b> |
| Loans and advances to banks:               |              |              |
| Latin America                              | 76           | 72           |

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|                            |              |              |
|----------------------------|--------------|--------------|
| USA                        | 315          | 69           |
| Europe                     | 1,470        | 1,853        |
| Rest of the world          | 936          | 803          |
|                            | 2,797        | 2,797        |
| <b>Total foreign loans</b> | <b>7,616</b> | <b>7,410</b> |



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| UK GAAP                                    | 2003<br>£m   | 2002<br>£m    | 2001<br>£m    |
|--|--------------|---------------|---------------|
| <b>Analysis of foreign loans by region</b> |              |               |               |
| Loans and advances to customers:           |              |               |               |
| New Zealand                                |              | 10,447        | 8,435         |
| Latin America                              | 557          | 1,591         | 2,347         |
| USA  | 2,681        | 3,412         | 3,059         |
| Europe                                     | 1,981        | 2,142         | 2,118         |
| Rest of the world                          | 623          | 648           | 474           |
|  | 5,842        | 18,240        | 16,433        |
| Loans and advances to banks:               |              |               |               |
| New Zealand                                |              | 622           | 534           |
| Latin America                              | 143          | 52            | 209           |
| USA  | 95           | 227           | 158           |
| Europe                                     | 1,408        | 1,164         | 1,379         |
| Rest of the world                          | 248          | 174           | 209           |
|  | 1,894        | 2,239         | 2,489         |
| <b>Total foreign loans</b>                 | <b>7,736</b> | <b>20,479</b> | <b>18,922</b> |

The classification of lending as domestic or foreign is based on the location of the office recording the transaction, except for certain lending of the international business booked in London.

## Summary of loan loss experience

The following tables analyse the movements in the allowance for impairment losses for each of the five years listed.

| IFRS  | 2005<br>£m     | 2004<br>£m     |
|---|----------------|----------------|
| <b>Balance at beginning of year</b>                                   |                |                |
| Domestic  | 1,562          | 1,468          |
| Foreign   | 101            | 227            |
| <b>Total balance at beginning of year before transition to IAS 39</b> | <b>1,663</b>   | <b>1,695</b>   |
| Adjustment to reflect transition to IAS 39 on 1 January 2005          | 256            |                |
| <b>Balance at beginning of year after transition to IAS 39</b>        | <b>1,919</b>   |                |
| <b>Exchange and other adjustments</b>                                 | <b>1</b>       | <b>(11)</b>    |
| <b>Reclassifications</b>  | <b>43</b>      |                |
| <b>Acquisition and disposal of businesses</b>                         | <b>(27)</b>    | <b>(33)</b>    |
| <b>Advances written off:</b>  |                |                |
| <b>Domestic</b>   |                |                |
| Loans and advances to customers:                                      |                |                |
| Mortgages   | (6)            | (2)            |
| Other personal lending  | (900)          | (760)          |
| Agriculture, forestry and fishing                                     | (1)            | (4)            |
| Manufacturing   | (26)           | (39)           |
| Construction  | (8)            | (3)            |
| Transport, distribution and hotels                                    | (37)           | (33)           |
| Financial, business and other services                                | (146)          | (17)           |
| Property companies  |                | (15)           |
| Lease financing   | (5)            | (3)            |
| Hire purchase   | (77)           | (49)           |
| Other   | (25)           | (36)           |
| Loans and advances to banks   |                | (15)           |
| <b>Total domestic</b>   | <b>(1,231)</b> | <b>(976)</b>   |
| <b>Foreign</b>  | <b>(5)</b>     | <b>(52)</b>    |
| <b>Total advances written off</b>                                     | <b>(1,236)</b> | <b>(1,028)</b> |
| <b>Recoveries of advances written off:</b>                            |                |                |
| <b>Domestic</b>   |                |                |
| Loans and advances to customers:                                      |                |                |
| Mortgages   | 2              | 2              |
| Other personal lending  | 124            | 119            |
| Agriculture, forestry and fishing                                     |                | 1              |
| Manufacturing   | 2              | 7              |
| Construction  | 1              | 7              |
| Transport, distribution and hotels                                    | 5              | 14             |
| Financial, business and other services                                | 14             | 14             |
| Hire purchase   | 5              | 6              |
| Other   | 2              | 1              |
| <b>Total domestic</b>   | <b>155</b>     | <b>171</b>     |

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|   |                |              |
|---|----------------|--------------|
| <b>Foreign</b>                                  | <b>3</b>       | <b>3</b>     |
| <hr/>   |                |              |
| <b>Total recoveries of advances written off</b> | <b>158</b>     | <b>174</b>   |
| <hr/>   |                |              |
| <b>Net advances written off:</b>                |                |              |
| Domestic  | <b>(1,076)</b> | <b>(805)</b> |
| Foreign   | <b>(2)</b>     | <b>(49)</b>  |
| <hr/>   |                |              |
| <b>Total net advances written off</b>           | <b>(1,078)</b> | <b>(854)</b> |
| <hr/>   |                |              |

| IFRS  | 2005<br>£m   | 2004<br>£m |
|---|--------------|------------|
| <b>Effect of unwinding of discount recognised through interest income</b>                   | <b>(87)</b>  |            |
| <b>Allowances for impairment losses charged against income for the year:</b>                |              |            |
| <b>Domestic</b>   |              |            |
| Loans and advances to customers:  |              |            |
| Mortgages   | 18           | 4          |
| Other personal lending  | 1,193        | 807        |
| Agriculture, forestry and fishing   |              | (3)        |
| Manufacturing   | 1            | (1)        |
| Construction  | (3)          | 4          |
| Transport, distribution and hotels  | 20           | 43         |
| Financial, business and other services  | 14           | (13)       |
| Property companies  |              | 15         |
| Lease financing   | (3)          | 7          |
| Hire purchase   | 70           | 57         |
| Other   | (4)          | 35         |
| General provisions  |              | (57)       |
| Loans and advances to banks   |              |            |
| <b>Total domestic</b>   | <b>1,306</b> | 898        |
| <b>Foreign</b>  | <b>(4)</b>   | (32)       |
| <b>Total allowances for impairment losses charged against income for the year</b>           | <b>1,302</b> | 866        |
| <b>Balance at end of year</b>   |              |            |
| Domestic  | 2,037        | 1,562      |
| Foreign   | 36           | 101        |
| <b>Total balance at end of year</b>   | <b>2,073</b> | 1,663      |
| <b>Ratio of net write-offs during the year to average loans outstanding during the year</b> | <b>0.6%</b>  | 0.6%       |

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| UK GAAP   | 2003<br>£m     | 2002<br>£m   | 2001<br>£m   |
|---|----------------|--------------|--------------|
| <b>Balance at beginning of year</b>             |                |              |              |
| Domestic  | 1,344          | 1,162        | 1,129        |
| Foreign   | 423            | 306          | 297          |
| <b>Total balance at beginning of year</b>       | <b>1,767</b>   | <b>1,468</b> | <b>1,426</b> |
| <b>Exchange and other adjustments</b>           | <b>(1)</b>     | <b>(58)</b>  | <b>(14)</b>  |
| <b>Acquisition and disposal of businesses</b>   | <b>(54)</b>    | <b>3</b>     |              |
| <b>Advances written off:</b>                    |                |              |              |
| <b>Domestic</b>                                 |                |              |              |
| Loans and advances to customers:                |                |              |              |
| Mortgages                                       | (1)            | (21)         | (23)         |
| Other personal lending                          | (691)          | (554)        | (456)        |
| Agriculture, forestry and fishing               | (11)           | (2)          | (9)          |
| Manufacturing                                   | (30)           | (25)         | (18)         |
| Construction                                    | (11)           | (17)         | (8)          |
| Transport, distribution and hotels              | (40)           | (27)         | (34)         |
| Financial, business and other services          | (11)           | (53)         | (44)         |
| Property companies                              | (36)           | (19)         | (21)         |
| Lease financing                                 | (4)            | (17)         | (11)         |
| Hire purchase                                   | (44)           | (50)         | (68)         |
| Other   | (47)           | (2)          | (9)          |
| Loans and advances to banks                     |                |              |              |
| <b>Total domestic</b>                           | <b>(926)</b>   | <b>(787)</b> | <b>(701)</b> |
| <b>Foreign</b>                                  | <b>(219)</b>   | <b>(91)</b>  | <b>(184)</b> |
| <b>Total advances written off</b>               | <b>(1,145)</b> | <b>(878)</b> | <b>(885)</b> |
| <b>Recoveries of advances written off:</b>      |                |              |              |
| <b>Domestic</b>                                 |                |              |              |
| Loans and advances to customers:                |                |              |              |
| Mortgages                                       | 2              | 5            | 17           |
| Other personal lending                          | 103            | 83           | 81           |
| Agriculture, forestry and fishing               | 2              | 3            | 4            |
| Manufacturing                                   | 6              | 17           | 5            |
| Construction                                    | 2              | 3            | 2            |
| Transport, distribution and hotels              | 7              | 12           | 10           |
| Financial, business and other services          | 7              | 13           | 11           |
| Property companies                              | 6              | 10           | 6            |
| Lease financing                                 | 1              | 3            | 4            |
| Hire purchase                                   | 6              | 15           | 22           |
| Other   |                | 1            | 3            |
| <b>Total domestic</b>                           | <b>142</b>     | <b>165</b>   | <b>165</b>   |
| <b>Foreign</b>                                  | <b>36</b>      | <b>38</b>    | <b>29</b>    |
| <b>Total recoveries of advances written off</b> | <b>178</b>     | <b>203</b>   | <b>194</b>   |
| <b>Net advances written off:</b>                |                |              |              |
| Domestic  | (784)          | (622)        | (536)        |
| Foreign   | (183)          | (53)         | (155)        |
| <b>Total net advances written off</b>           | <b>(967)</b>   | <b>(675)</b> | <b>(691)</b> |



| UK GAAP   | 2003<br>£m   | 2002<br>£m   | 2001<br>£m   |
|---|--------------|--------------|--------------|
| <b>Provision for loan losses charged against income for the year:</b>                       |              |              |              |
| <b>Domestic</b>   |              |              |              |
| Loans and advances to customers:  |              |              |              |
| Mortgages   | (19)         | (5)          | 2            |
| Other personal lending  | 679          | 514          | 423          |
| Agriculture, forestry and fishing   | 8            |              | 3            |
| Manufacturing   |              | 31           | 40           |
| Construction  | 11           | 14           | (2)          |
| Transport, distribution and hotels  | 26           | 28           | 28           |
| Financial, business and other services  | 49           | 107          | 39           |
| Property companies  | 22           | (1)          | 4            |
| Lease financing   | 2            | 3            | 5            |
| Hire purchase   | 40           | 57           | 47           |
| Other specific provisions   | 32           | 38           | 23           |
| General provisions  | 9            | 14           | (42)         |
| Loans and advances to banks   | 16           |              |              |
| <b>Total domestic</b>   | <b>875</b>   | <b>800</b>   | <b>570</b>   |
| <b>Foreign</b>  | <b>75</b>    | <b>229</b>   | <b>177</b>   |
| <b>Total provision for loan losses charged against income for the year</b>                  | <b>950</b>   | <b>1,029</b> | <b>747</b>   |
| <b>Balance at end of year</b>   |              |              |              |
| Domestic  | 1,468        | 1,344        | 1,162        |
| Foreign   | 227          | 423          | 306          |
| <b>Total balance at end of year</b>   | <b>1,695</b> | <b>1,767</b> | <b>1,468</b> |
| <b>Ratio of net write-offs during the year to average loans outstanding during the year</b> | <b>0.7%</b>  | <b>0.5%</b>  | <b>0.6%</b>  |

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The following tables analyse the coverage of the allowance for loan losses by category of loans.

| IFRS                                      | 2005<br>Allowance<br>£m | 2005<br>Percentage of<br>loans in each<br>category to<br>total loans<br>% | 2004<br>Allowance<br>£m | 2004<br>Percentage of<br>loans in each<br>category to<br>total loans<br>% |
|---|-------------------------|---|-------------------------|---|
| <b>Balance at year end applicable to:</b> |                         |   |                         |   |
| <b>Domestic:</b>                          |                         |   |                         |   |
| Loans and advances to banks               | 1                       | 13.8  | 1                       | 15.4  |
| Loans and advances to customers:          |                         |   |                         |   |
| Mortgages                                 | 36                      | 42.4  | 11                      | 42.3  |
| Other personal lending                    | 1,530                   | 10.9  | 788                     | 12.1  |
| Agriculture, forestry and fishing         | 2                       | 1.1   | 3                       | 1.1   |
| Manufacturing                             | 28                      | 2.9   | 64                      | 1.7   |
| Construction                              | 8                       | 1.0   | 17                      | 1.0   |
| Transport, distribution and hotels        | 58                      | 3.7   | 84                      | 3.6   |
| Financial, business and other services    | 165                     | 7.8   | 158                     | 7.1   |
| Property companies                        | 4                       | 4.0   |                         | 3.1   |
| Lease financing                           | 4                       | 2.8   | 10                      | 3.3   |
| Hire purchase                             | 99                      | 2.3   | 91                      | 2.6   |
| Other                                     | 102                     | 3.7   | 55                      | 2.8   |
| <b>Total domestic</b>                     | <b>2,037</b>            | <b>96.4</b>   | <b>1,282</b>            | <b>96.1</b>   |
| <b>Foreign</b>                            | <b>36</b>               | <b>3.6</b>  | <b>101</b>              | <b>3.9</b>  |
| <b>General provision</b>                  |                         |   | <b>280</b>              |   |
| <b>Total balance at year end</b>          | <b>2,073</b>            | <b>100.0</b>  | <b>1,663</b>            | <b>100.0</b>  |

| UK GAAP                                   | 2003<br>Allowance<br>£m | 2003<br>Percentage of<br>loans in each<br>category to<br>total loans<br>% | 2002<br>Allowance<br>£m | 2002<br>Percentage of<br>loans in each<br>category to<br>total loans<br>% | 2001<br>Allowance<br>£m | 2001<br>Percentage of<br>loans in each<br>category to<br>total loans<br>% |
|---|-------------------------|---|-------------------------|---|-------------------------|---|
| <b>Balance at year end applicable to:</b> |                         |   |                         |   |                         |   |
| <b>Domestic:</b>                          |                         |   |                         |   |                         |   |
| Loans and advances to banks               | 16                      | 9.0   |                         | 9.9   |                         | 9.1   |
| Loans and advances to customers:          |                         |   |                         |   |                         |   |
| Mortgages                                 | 7                       | 46.4  | 25                      | 40.7  | 44                      | 40.5  |
| Other personal lending                    | 622                     | 13.2  | 495                     | 10.8  | 452                     | 9.9   |
| Agriculture, forestry and fishing         | 9                       | 1.3   | 10                      | 1.3   | 9                       | 1.5   |
| Manufacturing                             | 97                      | 2.1   | 121                     | 2.2   | 98                      | 2.4   |
| Construction                              | 9                       | 1.0   | 7                       | 1.0   | 7                       | 0.9   |
| Transport, distribution and hotels        | 60                      | 3.1   | 67                      | 3.1   | 54                      | 3.2   |
| Financial, business and other services    | 179                     | 6.3   | 136                     | 5.4   | 65                      | 6.3   |
| Property companies                        |                         | 3.0   | 8                       | 2.6   | 18                      | 2.1   |
| Lease financing                           | 6                       | 4.2   | 7                       | 4.7   | 18                      | 5.4   |
| Hire purchase                             | 77                      | 3.1   | 75                      | 2.8   | 53                      | 3.1   |
| Other                                     | 50                      | 2.2   | 65                      | 2.2   | 30                      | 2.1   |
| <b>Total domestic</b>                     | <b>1,132</b>            | <b>94.9</b>   | <b>1,016</b>            | <b>86.7</b>   | <b>848</b>              | <b>86.5</b>   |
| <b>Foreign</b>                            | <b>181</b>              | <b>5.1</b>  | <b>318</b>              | <b>13.3</b>   | <b>251</b>              | <b>13.5</b>   |



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|                                  |       |       |       |       |       |       |
|----------------------------------|-------|-------|-------|-------|-------|-------|
| <b>General provision</b>         | 382   |       | 433   |       | 369   |       |
| <b>Total balance at year end</b> | 1,695 | 100.0 | 1,767 | 100.0 | 1,468 | 100.0 |

### **Risk elements in the loan portfolio**

The following discussion consists of an analysis of credit risk elements by categories which reflect US lending and accounting practices. These differ from those employed in the UK. In particular:

#### ***Non-performing lending***

2004

In the US, it is the normal practice to stop accruing interest when payments are 90 days or more past due or when recovery of both principal and interest is doubtful. When the loans are transferred to non-accrual status, accrued interest is reversed from income and no further interest is recognised until it becomes probable that the principal and interest will be repaid in full. Loans on which interest has been accrued but suspended would be included in risk elements as loans accounted for on a non-accrual basis.

In addition, in the US non-performing loans and advances are typically written off more quickly than in the UK. Consequently a UK bank may appear to have a higher level of non-performing loans and advances than a comparable US bank although the reported income is likely to be similar in both the US and the UK.

In accordance with IFRS, Lloyds TSB Group continued to accrue interest, where appropriate, on doubtful debts when there was a realistic prospect of recovery. This interest was charged to the customer's account but it was not credited to income; it was placed on a suspense account and only taken to income if there ceased to be significant doubt about its being paid. Loans were transferred to non-accrual status where the operation of the customer's account had ceased. This lending was managed by specialist recovery departments and written down to its estimated realisable value. Interest was not added to the lending or placed on a suspense account as its recovery was considered unlikely; it was only taken to income if it was received.

2005

In accordance with IFRS, Lloyds TSB Group continues to accrue and recognise interest on loans that have been written down as a result of an impairment loss. The interest recognised is based on the net carrying value of the loan and is less than that that would be recognised on a similar performing loan. Accordingly, no amounts are disclosed as non-accrual in 2005. If there is objective evidence that impairment has occurred and the carrying value of the loan exceeds the present value of its estimated future cash flows discounted at the loan's original effective interest rate then a provision is made.

As a result of the changes, Lloyds TSB Group now analyses its non-performing lending between impaired loans with a provision and impaired loans contractually past due 90 days or more without a provision.

#### ***Troubled debt restructurings***

In the US, loans whose terms have been modified due to problems with the borrower are required to be separately disclosed. If the new terms were in line with market conditions at the time of the restructuring and the restructured loan remains current as to repayment of principal and interest then the disclosure can be discontinued at the end of the first year.

There are no similar disclosure requirements in the UK.

#### ***Potential problem loans***

Potential problem loans are loans where known information about possible credit problems causes management to have concern as to the borrower's ability to comply with the present loan repayment terms. Interest continues to be accrued to the profit and loss account until, in the opinion of management, its ultimate recoverability becomes doubtful.

There are no similar disclosure requirements in the UK.

#### ***Assets acquired in exchange for advances***

In most circumstances in the US, title to property securing residential real estate transfers to the lender upon foreclosure. The loan is written off and the property acquired in this way is reported in a separate balance sheet category with any recoveries recorded as an offset to the provision for loan losses recorded in the year. Upon sale of the acquired property, gains or losses are recorded in the income statement as a gain or loss on acquired property.

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In the UK, although a bank is entitled to enforce a first charge on a property held as security, it typically does so only to the extent of enforcing its power of sale. In accordance with IFRS and industry practice, Lloyds TSB Group takes control of a property held as collateral on a loan at repossession but title does not transfer to it. Loans subject to repossession continue to be reported as loans in the balance sheet. Any gains or losses on sale of the acquired property are recorded within the provision for loan losses during the reporting period.

The difference in practices has no effect on net income reported in the UK compared to that reported in the US but it does result in a difference in classification of losses and recoveries in the income statement. It also has the effect of causing UK banks to report an increased level of non-performing loans compared with US banks.

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The following tables analyse risk elements in the loan portfolio as at 31 December for the last five years.

| IFRS  | 2005<br>£m | 2004<br>£m |
|---|------------|------------|
| <b>Loans accounted for on a non-accrual basis</b>   |            |            |
| Domestic offices  |            | 617        |
| Foreign offices   |            | 56         |
| Total non-accrual loans   |            | 673        |
| <b>Accruing loans on which interest is being placed in suspense</b>   |            |            |
| Domestic offices  |            | 527        |
| Foreign offices   |            | 40         |
| Total suspended interest loans  |            | 567        |
| <b>Accruing loans on which interest is still being accrued and taken to profit, and against which specific provisions have been made*</b> |            |            |
| Domestic offices  |            | 1,363      |
| Foreign offices   |            | 2          |
| Total accruing loans against which specific provisions have been made   |            | 1,365      |
| <b>Impaired lending against which provisions are held</b>   |            |            |
| Domestic offices  | 4,064      |            |
| Foreign offices   | 58         |            |
| Total impaired lending against which provisions are held  | 4,122      |            |
| <b>Loans contractually past due 90 days or more as to principal or interest, but against which no provisions have been made</b>           |            |            |
| Domestic offices  | 1,210      | 1,040      |
| Foreign offices   |            |            |
| Total accruing loans  | 1,210      | 1,040      |
| <b>Total non-performing lending</b>   |            |            |
|   | 5,332      | 3,645      |
| <b>Domestic offices</b>   |            |            |
|   | 5,274      | 3,547      |
| <b>Foreign offices</b>  |            |            |
|   | 58         | 98         |
| <b>Total non-performing lending</b>   |            |            |
|   | 5,332      | 3,645      |

Following the adoption of IAS 39 with effect from 1 January 2005, interest is accrued on all outstanding loans, including those treated as impaired; accordingly, it is no longer possible to classify non-performing lending as being accounted for on either a non-accrual basis or a suspended interest basis. As a result of these changes, the Lloyds TSB Group now analyses its non-performing lending between impaired loans with a provision and impaired loans contractually past due 90 days or more without a provision. This figure is not directly comparable to the amounts disclosed in 2004, because prior to the adoption of IAS 39 provisions were only established in the event that the recovery of the principal balance was in serious doubt.

\* Included within accruing loans on which interest is still being accrued and taken to profit, and against which specific provisions have been made, in 2004 was £1m in respect of troubled debt restructurings. There were no troubled debt restructurings in 2005.

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| UK GAAP   | 2003<br>£m   | 2002<br>£m   | 2001<br>£m   |
|---|--------------|--------------|--------------|
| <b>Loans accounted for on a non-accrual basis</b>   |              |              |              |
| Domestic offices  | 480          | 421          | 278          |
| Foreign offices   | 105          | 241          | 101          |
| <b>Total non-accrual loans</b>  | <b>585</b>   | <b>662</b>   | <b>379</b>   |
| <b>Accruing loans on which interest is being placed in suspense</b>   |              |              |              |
| Domestic offices  | 545          | 553          | 637          |
| Foreign offices   | 88           | 199          | 206          |
| <b>Total suspended interest loans</b>   | <b>633</b>   | <b>752</b>   | <b>843</b>   |
| <b>Accruing loans on which interest is still being accrued and taken to profit, and against which specific provisions have been made</b>  |              |              |              |
| Domestic offices  | 1,199        | 1,217        | 1,265        |
| Foreign offices   | 23           | 66           | 75           |
| <b>Total accruing loans against which specific provisions have been made</b>  | <b>1,222</b> | <b>1,283</b> | <b>1,340</b> |
| <b>Accruing loans on which interest is still being accrued and taken to profit, the lending is contractually past due 90 days or more as to principal or interest, but against which no provisions have been made</b> |              |              |              |
| Domestic offices  | 875          | 776          | 693          |
| Foreign offices   |              | 34           | 37           |
| <b>Total accruing loans against which no provisions have been made</b>  | <b>875</b>   | <b>810</b>   | <b>730</b>   |
| <b>Troubled debt restructurings</b>   |              |              |              |
| Domestic offices  | 1            | 1            | 1            |
| Foreign offices   |              | 2            | 9            |
| <b>Total troubled debt restructurings</b>   | <b>1</b>     | <b>3</b>     | <b>10</b>    |
| <b>Total non-performing lending</b>   |              |              |              |
| Domestic offices  | 3,100        | 2,968        | 2,874        |
| Foreign offices   | 216          | 542          | 428          |
| <b>Total non-performing lending</b>   | <b>3,316</b> | <b>3,510</b> | <b>3,302</b> |

***Interest foregone on non-performing lending***

The table below summarises the interest foregone on impaired lending.

|   | 2005<br>£m |
|---|------------|
| Interest income that would have been recognised under original contract terms | 362        |
| Interest income included in profit  | (209)      |
| <b>Interest foregone</b>  | <b>153</b> |

**Potential problem loans**

In addition to the non-performing lending disclosed above, lendings which were current as to payment of interest and principal but where concerns existed about the ability of the borrowers to comply with loan repayment terms in the near future were as follows:

| <b>IFRS</b>               | <b>2005</b>  | 2004  |
|---------------------------|--------------|-------|
|                           | <b>£m</b>    | £m    |
| Potential problem lending | <b>1,800</b> | 1,450 |

| <b>UK GAAP</b>            | 2003  | 2002  | 2001  |
|---------------------------|-------|-------|-------|
|                           | £m    | £m    | £m    |
| Potential problem lending | 1,696 | 1,734 | 1,423 |

The figures shown for potential problem lending are not indicative of the losses that might arise should the credit quality of this lending deteriorate since they do not take into account security held.

**Cross border outstandings**

The business of Lloyds TSB Group involves significant exposures in non-local currencies. These cross border outstandings comprise loans (including accrued interest), acceptances, interest-bearing deposits with other banks, other interest-bearing investments and any other monetary assets which are denominated in non-local currency. The following tables analyse, by type of borrower, foreign outstandings which individually represent in excess of 1 per cent of Lloyds TSB Group's total assets.

| <b>IFRS</b>                    | <b>% of assets</b> | <b>Total<br/>£m</b> | <b>Governments<br/>and official<br/>institutions<br/>£m</b> | <b>Banks and<br/>other<br/>financial<br/>institutions<br/>£m</b> | <b>Commercial,<br/>industrial<br/>and other<br/>£m</b> |
|--------------------------------|--------------------|---------------------|---|--|--|
| <b>As at 31 December 2005:</b> |                    |                     |   |  |  |
| Germany                        | 2.6                | 8,142               | 217   | 7,562  | 363  |
| Netherlands                    | 1.4                | 4,335               |   | 2,704  | 1,631  |
| Belgium                        | 1.3                | 4,133               | 12  | 4,006  | 115  |
| United States of America       | 1.3                | 3,974               | 312   | 899  | 2,763  |
| <b>As at 31 December 2004:</b> |                    |                     |   |  |  |
| Belgium                        | 2.5                | 7,033               | 796   | 6,161  | 76   |
| Germany                        | 2.1                | 5,872               | 331   | 5,118  | 423  |
| Netherlands                    | 1.2                | 3,480               | 415   | 2,173  | 892  |
| Japan                          | 1.1                | 3,235               | 550   | 1,037  | 1,648  |

| <b>UK GAAP</b>                 | <b>% of assets</b> | <b>Total<br/>£m</b> | <b>Governments<br/>and official<br/>institutions<br/>£m</b> | <b>Banks and<br/>other financial<br/>institutions<br/>£m</b> | <b>Commercial,<br/>industrial<br/>and other<br/>£m</b> |
|--------------------------------|--------------------|---------------------|---|--|--|
| <b>As at 31 December 2003:</b> |                    |                     |   |  |  |
| Germany                        | 2.3                | 4,553               | 284   | 3,851  | 418  |
| Italy                          | 1.7                | 3,510               | 2,411   | 759  | 340  |
| Belgium                        | 1.4                | 2,746               | 1,460   | 1,236  | 50   |
| United States of America       | 1.2                | 2,371               | 45  | 1,109  | 1,217  |
| Netherlands                    | 1.2                | 2,343               | 431   | 950  | 962  |

As at 31 December 2005, Belgium had commitments of £62 million, Germany had commitments of £569 million, Netherlands had commitments of £952 million, and United States of America had commitments of £994 million.

As at 31 December 2005, on an IFRS basis, the country with cross border outstandings of between 0.75 per cent and 1 per cent of assets, amounting to £2,448 million in total, was France.

As at 31 December 2004, on an IFRS basis, the countries with cross border outstandings of between 0.75 per cent and 1 per cent of assets, amounting to £4,767 million in total, were France and United States of America.

As at 31 December 2003, on an UK GAAP basis, the country with cross border outstandings of between 0.75 per cent and 1 per cent of assets, amounting to £1,828 million in total, was France.

## **Market risk**

### ***Definition***

The risk of reductions in earnings and/or value, through financial or reputational loss, arising from unexpected changes in financial prices, including interest rates, exchange rates and bond, commodity and equity prices. It arises in all areas of Lloyds TSB Group's activities and is managed by a variety of different techniques.

### ***Sources***

The Group's banking activities expose it to the risk of adverse movements in interest rates or exchange rates, with little or no exposure to equity or commodity risk.

Most of the Group's trading activity is undertaken to meet the requirements of wholesale and retail customers for foreign exchange and interest rate products. However, some interest rate and exchange rate positions are taken using derivatives and on-balance sheet instruments with the objective of earning a profit from favourable movements in market rates

Market risk in the Group's retail portfolios and in the Group's capital funds arises from the different repricing characteristics of the Group's banking assets and liabilities. Interest rate risk arises from the mismatch between interest rate insensitive liabilities and interest rate sensitive assets

Foreign currency risk also arises from the Group's investment in its overseas operations  
The Group's insurance activities also expose it to market risk, encompassing interest rate, exchange rate and equity risk.

The management of with-profits funds leads to assets and liabilities that are mismatched with the aim of generating a higher rate of return to meet policyholders' expectations

Unit-linked liabilities are matched with the same assets that are used to define the liability but future fee income is dependent upon the performance of these assets

For other insurance liabilities the aim is to invest in assets such that the cash flows on investments will match those on the projected future liabilities. It is not possible to eliminate risk completely as the timing of insured events is uncertain and bonds are not available at all of the required maturities. As a result the cash flows cannot be precisely matched and so sensitivity tests are used to test the extent of the mismatch

Surplus assets are held primarily in three portfolios; the surplus in the non-profit fund within the Long-Term Fund of Scottish Widows plc, assets in shareholder funds of life assurance companies and an investment portfolio within the general insurance business  
The Group's defined benefit pension schemes are exposed to significant risks from the constituent parts of their assets, primarily equity and interest rate risk, and from the present value of their liabilities.

### ***Control***

The group asset and liability committee regularly reviews market risk exposure and makes recommendations to the group chief executive concerning overall market risk appetite and market risk policy.

### ***Banking activity***

Trading is restricted to a number of specialist centres, the most important centre being financial markets division in London. These centres also manage market risk in the wholesale banking books, both in the UK and internationally. The level of exposure is strictly controlled and monitored within approved limits. Active management of the wholesale book is necessary to meet customer requirements and changing market circumstances.

Market risk in the Group's retail portfolios and in the Group's capital funds is managed within limits set out in the policy for group balance sheet management, which is reviewed annually and approved by the group asset and liability committee. The structural foreign exchange position is managed having regard to the currency composition of the Group's risk-weighted assets and reported to the group asset and liability committee on a monthly basis. The objective is to limit the effect of exchange rate movements on the published risk asset ratio.

### ***Insurance activity***



Market risk exposure from the insurance businesses are controlled via approved investment policies consistent with the Group's overall risk appetite and regularly reviewed by the group asset and liability committee

With-profits funds are managed in accordance with the relevant fund's Principles and Practices of Financial Management

The investment strategy for other insurance liabilities is determined by the term and nature of the underlying liabilities and asset/liability matching positions are actively monitored. Actuarial tools are used to project and match the cash flows

Investment strategy for surplus assets held in excess of liabilities takes account of the regulatory and internal business requirements for capital to be held to support the business now and in the future

The Group liaises with the pension scheme trustees with regard to strategies for the overall mix of pension assets.

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### *Risk appetite*

Market risk appetite is defined as the quantum and composition of market risk that exists currently in the Group and the direction in which the Group wishes to manage this.

This statement of the Group's overall appetite for market risk is reviewed and approved annually by the board. The group chief executive allocates this risk appetite across the Group. Individual members of the group executive committee ensure that market risk appetite is further delegated to an appropriate level within their areas of responsibility.

### *Exposures*

The primary market risk measure used within the Group is the Value at Risk (VaR) methodology, which incorporates the volatility of relevant market prices and the correlation of their movements. Although an important measure of risk, VaR has limitations as a result of its use of historical data, assumed distribution, holding periods and frequency of calculation. The use of confidence levels does not convey any information about potential loss when the confidence level is exceeded. VaR is also not well suited to options positions. The Group recognises these limitations and supplements its use with a variety of other techniques. These reflect the nature of the business activity, and include interest rate re-pricing gaps, open exchange positions and sensitivity analysis. Stress testing and scenario analysis are also used in certain portfolios and at group level, to simulate extreme conditions to supplement these core measures.

The risk of loss measured by the VaR model is the potential loss in earnings. The total and average trading VaR does not assume any diversification benefit across the three risk types. The maximum and minimum VaR reported for each risk category did not necessarily occur on the same day as the maximum and minimum VaR reported as a whole.

### *Trading*

Based on the commonly used 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding three years, the VaR for the years ended 31 December 2005 and 2004 based on the Group's global trading positions was as detailed in the table below (the table also aggregates potential loss measures from options portfolios).

|                                | 31 December 2005 |               |               |               | 31 December 2004 |               |               |               |
|--------------------------------|------------------|---------------|---------------|---------------|------------------|---------------|---------------|---------------|
|                                | Closing<br>£m    | Average<br>£m | Maximum<br>£m | Minimum<br>£m | Closing<br>£m    | Average<br>£m | Maximum<br>£m | Minimum<br>£m |
| Interest rate risk             | 0.9              | 1.8           | 4.5           | 0.5           | 0.7              | 0.9           | 1.7           | 0.5           |
| Foreign exchange risk          | 0.2              | 0.3           | 0.4           | 0.2           | 0.2              | 0.3           | 0.6           | 0.2           |
| Equity risk                    | 0.0              | 0.0           | 0.0           | 0.0           | 0.0              | 0.0           | 0.0           | 0.0           |
| Total VaR (no diversification) | 1.1              | 2.1           | 4.7           | 0.8           | 0.9              | 1.3           | 2.0           | 0.8           |

### *Non-trading*

The Group's banking non-trading exposure is summarised in the form of an interest rate repricing table, as set out in note 51 to the financial statements. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date. However, the table does not take into account the effect of interest rate options used by the Group to hedge its exposure.

It is estimated that a hypothetical immediate and sustained 100 basis point increase in interest rates on 1 January 2006 would decrease net interest income by £112.5 million for the 12 months to 31 December 2006, while a hypothetical immediate and sustained 100 basis point decrease in interest rates would increase net interest income by £104.7 million. An analysis by currency is shown below.

|   | UK     | North   | Asia &      | Europe & | Total   | Total  |
|---|--------|---------|-------------|----------|---------|--------|
|   | £m     | America | Australasia | Middle   | 2006    | 2005   |
|   | £m     | £m      | £m          | £m       | £m      | £m     |
| Change in net interest income from a +100 basis point shift in yield curves | (76.4) | (25.7)  | 0.1         | (10.5)   | (112.5) | (80.7) |

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|  |             |             |              |             |              |      |
|--|-------------|-------------|--------------|-------------|--------------|------|
| Change in net interest income from a 100 basis point shift in yield curves | <b>68.6</b> | <b>25.7</b> | <b>(0.1)</b> | <b>10.5</b> | <b>104.7</b> | 76.3 |
|--|-------------|-------------|--------------|-------------|--------------|------|

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The analysis above is subject to certain simplifying assumptions including, but not limited to, all rates of all maturities worldwide move simultaneously by the same amount; all positions in the wholesale books run to maturity; and there is no management action in response to movements in interest rates, in particular no changes to product margins.

In practice, positions in both the retail and wholesale books are actively managed and actual impact on net interest income may be different to the model.

The composition, and value, of both the Scottish Widows plc Non-Profit Fund and the General Insurance portfolio are reported to Group Risk on a monthly basis and a VaR is calculated which is presented to the group asset and liability committee. The VaR methodology used is the same in all respects to that used for the traded risk in banking activities, except that in the case of equity risk, the model maps the portfolio composition onto a series of appropriate indices by region and sector. In addition the risks are calculated based on a 99 per cent confidence level and a ten day holding period. The figures quoted below are the sum of the two portfolios with no allowance for diversification between portfolios or asset classes and represents the potential loss in earnings.

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The following table shows closing, average, maximum and minimum VaR for the years ended 31 December 2005 and 2004 on a 99 per cent confidence ten day basis.

|                       | 31 December 2005 |               |               |               | 31 December 2004 |               |               |               |
|-----------------------|------------------|---------------|---------------|---------------|------------------|---------------|---------------|---------------|
|                       | Closing<br>£m    | Average<br>£m | Maximum<br>£m | Minimum<br>£m | Closing<br>£m    | Average<br>£m | Maximum<br>£m | Minimum<br>£m |
| Interest rate risk    | 19.8             | 17.9          | 20.0          | 15.8          | 15.5             | 16.1          | 17.9          | 11.2          |
| Foreign exchange risk | 3.3              | 2.8           | 3.5           | 2.3           | 2.4              | 2.7           | 3.4           | 2.2           |
| Equity risk           | 41.7             | 47.7          | 57.3          | 39.4          | 55.2             | 54.2          | 56.4          | 51.6          |
| Total VaR             | 64.8             | 68.4          | 77.8          | 59.1          | 73.1             | 73.0          | 75.9          | 67.1          |

The Group's structural foreign exchange position at 31 December 2005 is set out in note 51 to the financial statements. The position implies that at 31 December 2005 a hypothetical increase of 10 per cent in the value of sterling against all other currencies would have led to a £42 million reduction in reserves, and vice versa. On this basis, there would have been no material impact on Lloyds TSB Group's risk asset ratios.

### Insurance risk

#### *Definition*

The risk of reductions in earnings and/or value, through financial or reputational loss, due to fluctuations in the timing, frequency and severity of insured/underwritten events and to fluctuations in the timing and amount of claim settlements. This includes fluctuations in profits due to customer behaviour.

#### *Sources*

The major sources of insurance risk within the Group are the insurance businesses and the Group's defined benefit pension schemes. The nature of insurance business involves the accepting of insurance risks which relate primarily to mortality, morbidity, persistency, expenses, property damage and unemployment. The prime insurance risk carried by the Group's pension schemes is related to mortality.

#### *Control*

Control is exercised primarily through a suitable combination of high level committees/boards. For the life assurance businesses the key control body is the board of Scottish Widows Group Limited with the more significant risks also being subject to approval by the Lloyds TSB group executive committee and/or the Lloyds TSB Group board. For the general insurance businesses the key control body is the Lloyds TSB Insurance executive committee with the more significant risks again being subject to Lloyds TSB group executive committee and/or Lloyds TSB Group board approval. All group pension scheme issues are covered by the group asset and liability committee.

Insurance risks are measured through deterministic studies of the impact of different insurance market scenarios on the future free assets of the business together with relevant stochastic modelling.

New insurance proposals are underwritten to ensure an appropriate premium is charged for the risk or the risk is declined.

Limits are used as a control mechanism for insurance risk at policy level.

#### *Exposures*

Some insurance risks are retained while others are reinsured with external underwriters. The retained risk level is carefully controlled and monitored, with close attention being paid to underwriting, claims management, product design, policy wordings, adequacy of reserves, solvency management and regulatory requirements.

General Insurance exposure to accumulations of risk and possible catastrophes is mitigated by reinsurance arrangements which are broadly spread over different reinsurers. Detailed modelling, including that of the probable maximum loss under various catastrophe scenarios, supports the choice of reinsurance arrangements. Appropriate reinsurance arrangements also apply within the life and pensions businesses with significant mortality risk and morbidity risk being transferred to our chosen reinsurers.

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Options and guarantees are incorporated in new insurance products only after careful consideration of the risk management issues that they present. This occurs as part of the new product approval process (see Product and service risk on page 39).

Expenses are monitored by an analysis of the Group's experience relative to budget. Reasons for any significant divergence from expectation are investigated and remedial action taken.

Persistency rates of life assurance policies, which relate to the rate of policy termination and the rate at which policies cease to pay regular premiums, are regularly assessed.

### **Operational risk**

The risk of reductions in earnings and/or value, through financial or reputational loss, from inadequate or failed internal processes and systems, or from people related or external events.

The Group continues to develop and refine its approach to managing operational risk. A consistent operational risk management framework for the timely identification, measurement, monitoring and control of operational risk has been

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introduced across the Group. Further development of operational risk metrics is taking place to seek to ensure that current and potential future operational risk exposures are understood in terms of both risk and reward potential.

The Group has seven sub operational risk types: governance risk, legal and regulatory risk, customer treatment risk, process and resource risk, theft, fraud and other criminal acts risk, people risk and change-related risk each of which is described in further detail below.

### **Governance**

#### *Definition*

The risk of reductions in earnings and/or value, through financial or reputational loss, from poor corporate governance at group, divisional and business unit level. Corporate governance in this context embraces the structures, systems and processes that provide direction, control and accountability for the enterprise.

#### *Control*

The Group's governance arrangements are based upon the following core principles:

the interests of shareholders and other stakeholders are protected by ensuring that excessive powers are not delegated to individuals;

decisions taken by management are consistent with the Group's strategic objectives and risk appetite, which are approved by the board;

managers are accountable for the management of risk, including internal controls, in their business;

risk management arrangements and risk exposures (including material transactions, financial positions or portfolios) are subject to independent oversight;

business is conducted in line with authorities and accountabilities ultimately delegated by the board; these are described within specific policies;

clear accountabilities are delegated by management to people who have the right level of skills, competencies and experience;

managers are required to safeguard against conflicts of interest;

every member of staff is responsible for understanding and managing the risk they take on behalf of the Group and for ensuring that they act within the authorities and accountabilities delegated to them; and

all staff are required to comply with group policies.

The Group's policy is to maintain good corporate governance arrangements, as it believes this is consistent with the Group's objective of maximising shareholder value over time. This includes the means by which risks are effectively managed in order to enable successful implementation of the Group's strategy. The Group's high level governance arrangements are described on pages 36 to 38. These arrangements reflect the Group's policy which is that the board adheres to the principles contained in the Combined Code on corporate governance, issued by the Financial Reporting Council, when determining and reviewing its governance arrangements. The directors review the application of the principles and provisions of the Code annually.

The policy regarding organisational structure is that the Group seeks to optimise performance by allowing divisions, subsidiaries and business units to operate within established capital and risk parameters and the Group's policy framework. Group policy requires that they must do so in a way which is consistent with realising the Group's strategy and meets agreed business performance targets.

Group functions (e.g. Group Human Resources, Group Risk, Group Finance, Group Strategy, Group Audit) are established to provide functional leadership (e.g. policy, strategy, and standards), challenge and support across the Group and ensure information is consolidated at group level.

Group Audit has unrestricted access to all functions, property, records and staff. It independently reviews adherence to the policies and processes that make up the control environment, disseminating best practices throughout the Group in the course of its monitoring and corrective action activities. The director of group audit reports to and meets regularly with the group chief executive and the audit committee chairman and periodically with the audit committee.

### **Legal and regulatory risk**

***Definition***

The risk of reductions in earnings and/or value, through financial or reputational loss, from failing to comply with the laws, regulations or codes applicable.

***Control***

The Group's business is regulated primarily by the UK Financial Services Authority ( FSA ), the Banking Code Standards Board (BCSB) and the Office of Fair Trading (OFT) and additionally by local regulators in offshore and overseas jurisdictions. Each business has a nominated individual with compliance oversight responsibility under FSA rules. The role of such individuals is to advise and assist management to ensure that each business has a control structure which creates awareness of the rules and regulations to which the Group is subject, and to monitor and report on adherence to these rules and regulations.

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All compliance personnel also have a reporting line to the group compliance director who sets compliance standards across the Group and provides independent reporting and assessment to the board and business directors.

Group Compliance also provides leadership on compliance with money laundering and terrorist financing legislation and regulation across the Group. It sets group policy and standards on the topic and undertakes high level oversight of anti money laundering risks. A specialist team within Group Compliance provides a centre of excellence on the relevant legislation and regulation as well as interfacing with external public and private bodies in order to evolve the Group's approach and seek to ensure greater effectiveness and focus on key risk areas. Its remit also includes compliance with financial sanctions.

Each business unit is responsible for complying with relevant laws and legal principles. Business units have access to legal advice both internal and external. The group chief legal adviser provides policies to assist business units identify areas where legal risk management procedures are necessary. Reports to the group chief legal adviser are required in relation to both significant litigation and also material legal issues.

The group compliance director and the group chief legal adviser have access to the chairman and group chief executive.

### **Customer treatment risk**

#### *Definition*

The risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate or poor customer treatment.

#### *Control*

The Group is committed to the fair treatment of its customers. It is an essential part of the way the Group conducts its business and develops deep long lasting relationships with its customers. A range of management information measures is in place across the Group to support the tracking of key customer treatment indicators. Group Risk and Group Audit are required to report regularly on customer treatment risk, management information trends and on compliance with the Group's standards.

Service improvements are monitored by customer satisfaction surveys, as well as internal process evaluations. The results of the research are fed into the Group's CARE Index, which measures ongoing performance against five principal objectives: customer understanding; accessibility; responsibility; expertise; and overall service quality improvement. This is tracked monthly and is a key indicator for the Group.

A framework is in place to guide the consideration and documentation of customer treatment risk when developing policies and procedures. The Group has defined customer treatment principles and benchmark standards in all the key areas and enhanced its processes and procedures for a number of individual initiatives including the governance of responsible lending and complaints handling. The divisions are required to meet or exceed these standards, tailoring customer treatment to the needs of each customer segment.

Trends across all the CARE Index categories are monitored and fed into a programme of continuous customer service improvement. The Group also provides its staff with clear FSA compliant guidelines and processes for dealing with customer complaints.

All advertising and marketing material is required to comply with the Group's governing policy on business conduct. Businesses are required to have procedures in place to seek to ensure that the material is clear, fair and not misleading bearing in mind the knowledge and sophistication of the customer. Any statement of fact should be substantiated through documentary evidence; any comparison should be made in a fair and balanced way; and any reference to past performance should clearly state the basis of measurement.

### **Process and resource risk**

#### *Definition*

The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from inadequate or failed internal processes and systems, people-related events, damage to resources (excluding human resources), and deficiencies in the performance of external suppliers/service providers.

#### *Control*

Businesses have primary responsibility for identifying and managing their process and resource risks. They employ internal control techniques to reduce their likelihood or impact to tolerable levels within the Group's risk appetite. Where appropriate, risk is mitigated by way of insurance.



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The Group has defined high-level process and resource risk policies to seek to ensure a wide-ranging and consistent approach to the identification and management of process and resource risk.

### **Theft, fraud and other criminal acts risk**

#### *Definition*

The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from frauds carried out against the Group, and/or theft of the Group's assets, and other criminal acts.

***Control***

The Group has in place appropriate policies, procedures and tools for the management of theft, fraud and other criminal acts risks.

Business units and group functions have primary responsibility for identifying and managing fraud risk at a local level in consultation with the Group Financial Crime Unit. Additionally the group fraud strategy and policy committee is responsible for monitoring fraud risk as well as ensuring that fraud risks are effectively identified and assessed and that strategies for fraud prevention are effectively coordinated.

Group Security has primary responsibility for the security of the people, premises and assets, including identifying and developing countermeasures to minimise the impact of physical threats to the Group. Business unit management seek to ensure that the level of security risk applicable to each site they occupy is assessed, and that the appropriate security countermeasures are determined in order to protect people, premises and assets.

**People**

***Definition***

The risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate staff behaviour, industrial action or health and safety issues. Loss can also be incurred through failure to recruit, retain, train, reward and incentivise appropriately skilled staff to achieve business objectives and through failure to take appropriate action as a result of staff underperformance.

***Control***

The Group's approach to people management is to employ skilled, committed staff, working as a team for the benefit of customers and shareholders, who are given the opportunity to fulfil their potential; employ the highest ethical standards of behaviour and best practice management principles; and recruit on the basis of ability and competence.

Standards of behaviour. The Group has a code of business conduct which applies to all employees. It seeks to ensure that employees act with integrity and endeavour to deliver high levels of customer service. It promotes a working environment free from discrimination, harassment, bullying or victimisation of any kind. Employees are encouraged and expected to alert management to suspected misconduct, fraud or other serious malpractice. We provide mechanisms to facilitate disclosure if an employee is unable to inform their direct line management and will thoroughly investigate any reports made in good faith. The code as amended from time to time is available to the public on the Group's website at [www.lloydstsb.com](http://www.lloydstsb.com).

Performance and reward management. The Group seeks to ensure that all employees understand their role, the purpose of the role and where it fits into the wider team and organisational context. It manages and measures employees' performance and contribution to collective goals and recognises the contribution of individuals in the context of the pay market and the performance of the business in which they work and rewards appropriately.

Training and development. The Group believes that long-term success depends on the quality and skills of its staff and that it has a joint responsibility with employees for their personal and career development to improve current performance and to enhance future prospects.

**Change-related risk**

***Definition***

Change-related risk is the risk of reductions in earnings and/or value, through financial or reputational loss, from change initiatives failing to deliver to requirements, budget or timescale or failing to implement change effectively or realise the desired benefits.

***Control***

To deliver the Group's strategic aims, change must be managed in an effective, risk-aware and appropriately controlled manner throughout the organisation. The Group's change management standards seek to ensure appropriate control across the project portfolio and the approach is regularly benchmarked against other leading institutions and practices. The Group's change management committee reviews the overall change portfolio monthly, with particular focus on initiatives having a high impact on customers and staff. The committee ensures that the aggregate impact of the implementation of change on customers, staff and systems is understood, managed and controlled.

**Financial soundness**

*Definition*

The risk of financial failure arising from lack of liquidity or capital, poor management or poor quality/volatile earnings.

Liquidity risk is defined as the risk of a loss arising from the Group's inability to meet its financial obligations as they fall due. These obligations include the repayment of deposits on demand or at their contractual maturity; the repayment of loan capital and other borrowings as they mature; the payment of insurance policy benefits, claims and surrenders; the payment of lease obligations as they become due; the payment of operating expenses and taxation; the payment of dividends to shareholders; the ability to fund new and existing loan commitments; and the ability to take advantage of new business opportunities.

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The international standard for measuring capital adequacy is the risk asset ratio, which relates to on- and off-balance sheet exposures weighted according to broad categories of risk. The Group's capital ratios, calculated in line with the requirements of the FSA, are set out in detail on page 63.

### ***Control***

A policy is in place which requires a common methodology to measuring liquidity across the Group. The methodology derives a liquidity ratio calculated by taking the sum of liquid assets, five-day wholesale inflows and back-up lines, and then dividing this by the sum of five-day wholesale outflows and a percentage of retail maturities and contingent claims drawable over the next five days. The Group complies with the FSA's liquidity requirements and with similar liquidity policies in place across all trading centres worldwide. Compliance is monitored by regular liquidity returns to Group Treasury. Work is ongoing to seek to ensure the Group's compliance with the new liquidity framework being proposed by the FSA. The liquidity policy requires all authorised local treasury operations to maintain a liquidity ratio of over 100 per cent, in addition to ensuring compliance with local regulatory requirements. It is the responsibility of local line management to ensure that the liquidity policy is met and the sources and maturities of assets and liabilities are continually managed and appropriately diversified to avoid any undue concentration as market conditions evolve. Compliance is monitored by regular liquidity returns to Group Treasury.

For non-linked funds investments are arranged to minimise the possibility of being a distressed seller whilst at the same time investing to meet policyholder obligations. For unit-linked business, deferral provisions are designed to give time to realise linked assets without being a forced seller.

Lloyds TSB Group and its regulated subsidiary banks have been allocated an Individual Capital Ratio by the FSA, and the board has agreed a formal buffer to be maintained in addition to the Individual Capital Ratio. Actual or prospective breaches of the formal buffer must be notified to the FSA, together with proposed remedial action; no such notifications have been made during 2005. Informally, a further buffer is maintained. In addition, the board has agreed a maximum limit of the proportion of debt instruments in the capital base. Risk-weighted assets are monitored by businesses, while capital is controlled centrally.

Capital ratios are a key factor in the Group's budgeting and planning processes and updates of expected ratios are prepared regularly during the year. Capital raised takes account of expected growth and currency of risk assets and also allows for the sensitivity of the Group's capital to movements in equity markets.

The Group seeks to use appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates. Each reporting entity within the Group has a finance function which is responsible for the production of financial, management and regulatory information. It is the responsibility of Group Finance to produce consolidated information for use internally and to meet external regulatory and statutory reporting requirements. Group Finance requires businesses and reporting entities to follow common processes and reporting standards.

Businesses or reporting entities have formal month-end and quarter-end procedures in place for preparation of management and financial accounts respectively, review and approval of management accounts at a determined level of detail, ensuring consistency with financial accounts, and preparation of forecasts and detailed annual budgets that are subject to formal review and approval. They are further required to implement measures to monitor performance at local level to identify significant fluctuations or unusual activity.

### **Liquidity and capital resources**

#### ***Liquidity sources***

The principal sources of liquidity for Lloyds TSB Group plc are dividends received from its directly owned subsidiary company, Lloyds TSB Bank, and loans from this and other Lloyds TSB Group companies. The ability of Lloyds TSB Bank to pay dividends, or for Lloyds TSB Bank or other Lloyds TSB Group companies to make loans to Lloyds TSB Group plc, depends on a number of factors, including their own regulatory capital requirements, distributable reserves and financial performance.

Lloyds TSB Group plc is also able to raise funds by issuing loan capital or equity, although in practice Lloyds TSB Group plc has never issued equity for this purpose and the majority of Lloyds TSB Group's loan capital has been issued by Lloyds TSB Bank. As at 31 December 2005, Lloyds TSB Group plc had £1,502 million of subordinated debt in issuance compared with £12,402 million for the consolidated Lloyds TSB Group. The cost and availability of subordinated debt finance are influenced by credit ratings. A reduction in these ratings could increase the cost and could reduce market access. At 31 December 2005, the credit ratings of Lloyds TSB Bank were as follows:

**Senior debt**

---

Moody's

**Aaa**

The ratings outlook from Moody's for Lloyds TSB Bank is stable. The Standard & Poor's ratings outlook was revised from negative to stable on 22 March 2006. These credit ratings are not a recommendation to buy, hold or sell any security; and each rating should be evaluated independently of every other rating.

A significant part of the liquidity of the Lloyds TSB Group's banking businesses arises from their ability to generate customer deposits. A substantial proportion of the customer deposit base is made up of current and savings accounts which, although repayable on demand, have traditionally provided a stable source of funding. During 2005, amounts

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deposited by customers increased by £11,259 million from £119,811 million at 31 December 2004 to £131,070 million at 31 December 2005. These customer deposits are supplemented by the issue of subordinated loan capital and wholesale funding sources in the capital markets, as well as from direct customer contracts. Wholesale funding sources include deposits taken on the inter-bank market, certificates of deposit, sale and repurchase agreements, a Euro Medium-Term Note programme, of which £6,683 million had been utilised for senior funding at 31 December 2005, and a commercial paper programme, under which £3,011 million had been utilised at 31 December 2005.

The ability to sell assets quickly is also an important source of liquidity for the Lloyds TSB Group's banking businesses. The Lloyds TSB Group holds sizeable balances of marketable debt securities which could be disposed of to provide additional funding should the need arise.

The following table sets out the amounts and maturities of Lloyds TSB Group's contractual cash obligations at 31 December 2005.

|                                 | Within<br>one year<br>£m | One to<br>three years<br>£m | Three to<br>five years<br>£m | Over five<br>years<br>£m | Total<br>£m   |
|---------------------------------|--------------------------|-----------------------------|------------------------------|--------------------------|---------------|
| Long-term debt dated            | 250                      | 674                         | 402                          | 3,343                    | 4,669         |
| Euro Medium-Term Note programme | 54                       | 661                         | 1,041                        | 4,927                    | 6,683         |
| Commercial paper programme      | 3,011                    |                             |                              |                          | 3,011         |
| Securitisation vehicles         | 7,415                    |                             |                              |                          | 7,415         |
| Finance leases                  | 1                        |                             |                              | 15                       | 16            |
| Operating leases                | 216                      | 408                         | 376                          | 1,016                    | 2,016         |
| Capital commitments             | 226                      | 28                          |                              |                          | 254           |
| Other purchase obligations      | 507                      | 686                         | 409                          | 186                      | 1,788         |
|                                 | <b>11,680</b>            | <b>2,457</b>                | <b>2,228</b>                 | <b>9,487</b>             | <b>25,852</b> |

Other purchase obligations include amounts expected to be payable in respect of material contracts entered into by the Lloyds TSB Group, in the ordinary course of business, for the provision of outsourced and other services. The cost of these services will be charged to the income statement as it is incurred. The Lloyds TSB Group also has a constructive obligation to ensure that its defined post-retirement benefit schemes remain adequately funded. The amount and timing of the Lloyds TSB Group's cash contributions to these schemes is uncertain and will be affected by factors such as future investment returns and demographic changes. Lloyds TSB Group expects to make cash contributions of approximately £520 million to these schemes in 2006.

At 31 December 2005, Lloyds TSB Group also had £7,733 million of undated long-term debt outstanding.

### *Off-balance sheet arrangements*

The following table sets out the amounts and maturities of Lloyds TSB Group's other commercial commitments at 31 December 2005. These commitments are not included in Lloyds TSB Group's consolidated balance sheet.

|                              | Within<br>one year<br>£m | One to<br>three years<br>£m | Three to<br>five years<br>£m | Over five<br>years<br>£m | Total<br>£m   |
|------------------------------|--------------------------|-----------------------------|------------------------------|--------------------------|---------------|
| Acceptances                  | 33                       | 2                           |                              |                          | 35            |
| Guarantees                   | 7,386                    | 590                         | 1,197                        | 200                      | 9,373         |
| Other contingent liabilities | 1,735                    | 365                         | 70                           | 117                      | 2,287         |
|                              | <b>9,154</b>             | <b>957</b>                  | <b>1,267</b>                 | <b>317</b>               | <b>11,695</b> |
| Lending commitments          | 54,145                   | 8,554                       | 12,413                       | 4,321                    | 79,433        |
| Other commitments            | 444                      | 14                          | 88                           | 14                       | 560           |
|                              | <b>54,589</b>            | <b>8,568</b>                | <b>12,501</b>                | <b>4,335</b>             | <b>79,993</b> |

|                                   |        |       |        |       |        |
|-----------------------------------|--------|-------|--------|-------|--------|
| Total contingents and commitments | 63,743 | 9,525 | 13,768 | 4,652 | 91,688 |
|-----------------------------------|--------|-------|--------|-------|--------|

Lending commitments are agreements to lend to customers in accordance with contractual provisions; these are either for a specified period or, as in the case of credit cards and overdrafts, represent a revolving credit facility which can be drawn down at any time, provided that the agreement has not been terminated. The total amounts of unused commitments do not necessarily represent future cash requirements, in that commitments often expire without being drawn upon.

Lloyds TSB Group's banking businesses are also exposed to liquidity risk through the provision of securitisation facilities to certain corporate customers. Lloyds TSB Group currently offers securitisation facilities to its corporate and financial institution client base through two conduit securitisation vehicles, Cancara Asset Securitisation Limited (Cancara) and Obelisk Funding (No.2) Limited (Obelisk). These are funded in the global asset-backed commercial paper market. The assets and obligations of Cancara and Obelisk are included in Lloyds TSB Group's consolidated balance sheet. Lloyds TSB Group provides short-term asset-backed commercial paper liquidity support facilities on commercial terms to the

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issuers of the commercial paper, for use in the event of a market disturbance should they be unable to roll over maturing commercial paper or obtain alternative sources of funding.

As at 31 December 2005 Cancara and Obelisk held assets of approximately £7.4 billion, primarily loans and investments. Lloyds TSB Bank provided asset-backed commercial paper liquidity support facilities of approximately £8.3 billion.

Within Lloyds TSB Group's insurance and investments businesses, the principal sources of liquidity are premiums received from policyholders, charges levied upon policyholders, investment income and the proceeds from the sale and maturity of investments. The investment policies followed by Lloyds TSB Group's life assurance companies take account of anticipated cash flow requirements including by matching the cash inflows with projected liabilities where appropriate. Cash deposits and highly liquid government securities are available to provide liquidity to cover any higher than expected cash outflows.

Based upon the levels of resources within the banking and insurance and investments businesses and the ability of Lloyds TSB Group to access the wholesale money markets or issue debt securities should the need arise, Lloyds TSB Group believes that its overall liquidity is sufficient to meet current obligations to customers, policyholders and debt holders, support expectations for future changes in asset and liability levels and carry on normal operations.

### *Capital resources*

The total capital resources of Lloyds TSB Group are set out below:

| IFRS                    | 31 December<br>2005<br>£m | 31 December<br>2004<br>£m | 1 January<br>2004<br>£m |
|-------------------------|---------------------------|---------------------------|-------------------------|
| Called-up share capital | 1,420                     | 1,419                     | 1,418                   |
| Share premium account   | 1,170                     | 1,145                     | 1,136                   |
| Other reserves          | 383                       | 343                       | 343                     |
| Retained profits        | 7,222                     | 8,140                     | 7,646                   |
| Shareholders' equity    | 10,195                    | 11,047                    | 10,543                  |
| Minority interests      | 435                       | 631                       | 782                     |
|                         | <b>10,630</b>             | 11,678                    | 11,325                  |
| Undated loan capital    | 7,733                     | 5,852                     | 5,959                   |
| Dated loan capital      | 4,669                     | 4,400                     | 4,495                   |
|                         | <b>23,032</b>             | 21,930                    | 21,779                  |

Lloyds TSB Group's total capital resources increased by £1,102 million during 2005. Shareholders' equity decreased by £852 million as the reduction of £1,558 million following the implementation of IAS 39 and IFRS 4 on 1 January 2005 was only partly offset by the profit for the year, after dividends. Minority interests were £196 million lower as the impact of the reclassification of certain instruments to loan capital was partly offset by third party investment in a new structured finance transaction and increased minority interests in Scottish Widows entities. Loan capital increased by £2,150 million due to the reclassification, on adoption of IAS 39 on 1 January 2005, of certain capital instruments from minority interests (£585 million) together with new issues in the year.

### *Capital ratios*

#### **Lloyds TSB Group**

The Group's regulatory capital is divided into tiers defined by the European Community Banking Consolidation Directive as implemented in the UK by the FSA's Interim Prudential Sourcebook for Banks. Tier 1 comprises mainly shareholders' equity, tier 1 capital instruments and minority interests, after deducting goodwill and other intangible assets. Tier 2 comprises collective impairment provisions, and qualifying subordinated loan capital, with restrictions on the amount of collective impairment provisions and loan capital which may be included. The amount of qualifying tier 2 capital cannot exceed that of tier 1 capital. Total capital is reduced by deducting investments in subsidiaries and associates which are not consolidated for regulatory purposes and investments in the capital of other credit/financial institutions. In the case of Lloyds TSB Group, this means that the net assets of its life assurance and general insurance businesses are deducted from its regulatory capital.



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Risk-weighted assets are determined according to a broad categorisation of the nature of each asset or exposure and counterparty and, for the trading book, by taking into account market-related risks.

The risk asset ratio as at 31 December 2005 is shown below and, in order to provide a meaningful comparison, a risk asset ratio as at 1 January 2005 is also shown, since this is the date from which IAS 39 and IFRS 4 have been applied. Risk asset ratios on a UK GAAP basis are shown as at 31 December 2004 and 31 December 2003.

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| <b>IFRS</b>                       | <b>31 December<br/>2005<br/>£m</b> | 1 January<br>2005<br>£m |
|-----------------------------------|------------------------------------|-------------------------|
| <b>Capital:</b>                   |                                    |                         |
| Tier 1                            | <b>11,478</b>                      | 10,753                  |
| Tier 2                            | <b>10,447</b>                      | 8,767                   |
|                                   | <b>21,925</b>                      | 19,520                  |
| Supervisory deductions            | <b>(6,160)</b>                     | (6,219)                 |
| <b>Total regulatory capital</b>   | <b>15,765</b>                      | 13,301                  |
| <b>Total risk-weighted assets</b> | <b>144,921</b>                     | 131,830                 |
| <b>Risk asset ratios:</b>         |                                    |                         |
| Total capital                     | <b>10.9%</b>                       | 10.1%                   |
| Tier 1                            | <b>7.9%</b>                        | 8.2%                    |

| <b>UK GAAP</b>                    | 31 December<br>2004<br>£m | 31 December<br>2003<br>£m |
|-----------------------------------|---------------------------|---------------------------|
| <b>Capital:</b>                   |                           |                           |
| Tier 1                            | 11,725                    | 11,223                    |
| Tier 2                            | 8,800                     | 8,935                     |
|                                   | 20,525                    | 20,158                    |
| Supervisory deductions            | (7,252)                   | (6,898)                   |
| <b>Total regulatory capital</b>   | 13,273                    | 13,260                    |
| <b>Total risk-weighted assets</b> | 132,173                   | 117,732                   |
| <b>Risk asset ratios:</b>         |                           |                           |
| Total capital                     | 10.0%                     | 11.3%                     |
| Tier 1                            | 8.9%                      | 9.5%                      |

At 31 December 2005, the risk asset ratios were 10.9 per cent for total capital and 7.9 per cent for tier 1 capital. The 7.9 per cent tier 1 capital ratio appears higher than would perhaps be expected and reflects the higher level of supervisory deductions resulting from the Lloyds TSB Group's significant investment in its life assurance operations.

The Lloyds TSB Group's capital management policy is focused on optimising value for shareholders. There is a clear focus on delivering organic growth and expected capital retentions are sufficient to support planned levels of growth. However, management also wishes to maintain the flexibility to make value enhancing in market acquisitions and therefore, at this stage, there are no plans to return capital to shareholders other than by way of dividend payments. Management will keep all options for the utilisation of capital under review.

There are strict limits imposed by the regulatory authorities as to the proportion of the Lloyds TSB Group's regulatory capital base that can be made up of subordinated debt and preferred securities. The Lloyds TSB Group's capacity to raise new debt capital for regulatory purposes increases as profits are retained; at 31 December 2005 the Lloyds TSB Group had capacity to raise approximately £1,000 million of tier 2 debt capital. The unpredictable nature of movements in the value of the investments supporting the long-term assurance funds could cause the amount of qualifying tier 2 capital to be restricted because of falling tier 1 resources. The Lloyds TSB Group seeks to ensure that even in the event of such restrictions the total capital ratio will remain adequate.

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During 2005, total capital for regulatory purposes increased by £2,464 million to £15,765 million. Tier 1 capital increased by £725 million, mainly as a result of profit retentions. Tier 2 capital increased by £1,680 million following loan capital issues and the inclusion of higher levels of collective impairment provisions. There was a decrease in supervisory deductions of £59 million, as profits for the year within the insurance and investment businesses were more than offset by dividends paid out.

### **Life assurance businesses**

#### *Basis of determining regulatory capital of the life assurance business*

##### *Available capital resources*

Available capital resources represent the excess of assets over liabilities calculated in accordance with detailed regulatory rules issued by the FSA. Different rules apply depending on the nature of the fund, as detailed below.

*Statutory basis.* Assets are generally valued on a basis consistent with that used for accounting purposes (with the exception that, in certain cases, the value attributed to assets is limited) and which follows a market value approach where possible. With the express permission of the FSA, an intangible asset can be recognised which represents the present value of future releases of prudent margins on business written. The liabilities are calculated using a projection of future cash flows after making prudent assumptions about matters such as investment return, expenses and mortality. Discount rates used to value the liabilities are set with reference to the risk adjusted yields on the underlying assets in accordance with the FSA rules. Other assumptions are based on recent actual experience, supplemented by industry information where appropriate. The assessment of liabilities does not include future bonuses for with-profits policies that are at the discretion of the Company, but does include a value for policyholder options likely to be exercised.

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*Realistic basis.* The FSA requires each life assurance company which contains a with-profits fund in excess of £500 million, including Scottish Widows plc ( Scottish Widows ), to carry out a realistic valuation of that fund. The word realistic in this context reflects the terminology used for reporting to the FSA and is an assessment of the financial position of a with-profits fund calculated under a prescribed methodology.

The valuation of with-profits assets in the With-Profits Fund on a realistic basis differs from the valuation on a statutory basis as, in respect of non-profits business written in the With-Profits Fund, it includes the present value of the anticipated future release of the prudent margins for adverse deviation. The realistic valuation uses the market value of assets without the limit affecting the statutory basis noted above.

The realistic valuation of liabilities is carried out using a stochastic simulation model which values liabilities on a basis consistent with tradable market option contracts (a market-consistent basis). The model takes account of policyholder behaviour on a best-estimate basis and includes an adjustment to reflect future uncertainties where the exercise of options by policyholders might increase liabilities. Further details regarding the stochastic simulation model are given below in the section entitled Options and guarantees .

### *Regulatory capital requirements*

Each life assurance company must retain sufficient capital to meet the regulatory capital requirements mandated by the FSA; the basis of calculating the regulatory capital requirement is given below. For Abbey Life Assurance Company Limited ( Abbey Life ), the regulatory capital requirement is a combination of amounts held in respect of actuarial reserves and sums at risk (the Long-Term Insurance Capital Requirement) and amounts required to cover various stress tests. The regulatory capital requirement is deducted from the available capital resources to give statutory excess capital .

For Scottish Widows, a further test is required in respect of the With-Profits Fund which compares the level of realistic excess capital to the statutory excess capital of the With-Profits Fund and, in circumstances where the realistic excess capital position is less, the Company is required to hold additional capital to cover the shortfall. The realistic excess capital is calculated as the difference between realistic assets and realistic liabilities of the With-Profits Fund with a further deduction to cover various stress tests. Any additional capital requirement under this test is referred to as the With-Profits Insurance Capital Component.

The determination of realistic liabilities of the With-Profits Fund in respect of Scottish Widows includes the value of internal transfers expected to be made from the With-Profits Fund to the Non-Profit Fund of Scottish Widows. These internal transfers include charges on policies where the associated costs are borne by the Non-Profit Fund. The value of the transfers exceeds the value of the costs which, in the case of Scottish Widows, results in the somewhat artificial increase in the With-Profits Insurance Capital Component of over £500 million.

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**Capital statement**

The following table provides more detail regarding the sources of capital in the life assurance business and reconciles those amounts to the Group's balance sheet. The figures below are those quoted in the Lloyds TSB Group's Annual Report and Accounts. The annual financial return submitted to the FSA was not materially different.

|  | Scottish Widows plc     |                       |                            |                           |                       | Consolidation adjustments<br>£m | Total life business on a Group basis<br>£m | Other sources of capital<br>£m | Consolidation adjustments<br>£m | Group total<br>£m |
|--|-------------------------|-----------------------|----------------------------|---------------------------|-----------------------|---------------------------------|--|--------------------------------|---------------------------------|-------------------|
|  | With-Profits Fund<br>£m | Non-Profit Fund<br>£m | Total Long-Term Fund<br>£m | Shareholder's funds<br>£m | Statutory basis<br>£m |                                 |  |                                |                                 |                   |
| Assets attributable to the shareholder held outside the long-term funds  |                         |                       |                            | 1,513                     | 1,513                 |                                 |  |                                |                                 |                   |
| Assets attributable to the shareholder held within the long-term funds   |                         | 2,619                 | 2,619                      |                           | 2,619                 |                                 |  |                                |                                 |                   |
| <b>Total shareholders' funds</b>   |                         | <b>2,619</b>          | <b>2,619</b>               | <b>1,513</b>              | <b>4,132</b>          | <b>1,346</b>                    | <b>5,478</b>                               | <b>9,909</b>                   | <b>(5,192)</b>                  | <b>10,195</b>     |
| Adjustments onto a regulatory basis:   |                         |                       |                            |                           |                       |                                 |  |                                |                                 |                   |
| Life assurance business  |                         |                       |                            |                           |                       |                                 |  |                                |                                 |                   |
| Unallocated surplus within insurance business  | 494                     |                       | 494                        |                           | 494                   |                                 |  |                                |                                 |                   |
| Adjustments to remove differences between IFRS and regulatory valuation of assets and liabilities                                      |                         | (456)                 | (456)                      | (767)                     | (1,223)               |                                 |  |                                |                                 |                   |
| Adjustment to include estimated realistic liabilities payable to the shareholder   | (729)                   |                       | (729)                      |                           | (729)                 |                                 |  |                                |                                 |                   |
| Adjustment to replace realistic liabilities with statutory liabilities   | 2,580                   |                       | 2,580                      |                           | 2,580                 |                                 |  |                                |                                 |                   |
| Adjustment to remove the value of future profits recognised in respect of non-participating contracts written in the With-Profits Fund | (43)                    |                       | (43)                       |                           | (43)                  |                                 |  |                                |                                 |                   |
| Recognition of future profits for regulatory capital purposes  |                         | 500                   | 500                        |                           | 500                   |                                 |  |                                |                                 |                   |
| Banking business   |                         |                       |                            |                           |                       |                                 |  |                                |                                 |                   |
| Collective impairment provisions   |                         |                       |                            |                           |                       |                                 |  | 1,782                          |                                 | 1,782             |
| Goodwill   |                         |                       |                            |                           |                       |                                 |  | (2,373)                        |                                 | (2,373)           |
| Pensions deficit adjustment  |                         |                       |                            |                           |                       |                                 |  | 1,372                          |                                 | 1,372             |

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|  |       |       |       |       |       |       |  |  |        |  |         |
|--|-------|-------|-------|-------|-------|-------|--|--|--------|--|---------|
| Other  |       |       |       |       |       |       |  |  | 13     |  | 13      |
| Qualifying loan capital                        |       |       |       | 561   | 561   | (561) |  |  | 10,936 |  | 10,936  |
| Available capital resources insurance business | 2,302 | 2,663 | 4,965 | 1,307 | 6,272 |       |  |  |        |  |         |
| Supervisory deductions                         |       |       |       |       |       |       |  |  |        |  |         |
| Net investment in life assurance business      |       |       |       |       |       |       |  |  |        |  | (5,478) |
| Other  |       |       |       |       |       |       |  |  |        |  | (682)   |
| Available capital resources Group              |       |       |       |       |       |       |  |  |        |  | 15,765  |

The figures shown above for available capital resources within the insurance business relate to Scottish Widows plc only. The amounts relating to the other life assurance subsidiaries within the Group are not significant.

*Formal intra-group capital arrangements*

Scottish Widows has a formal arrangement with one of its subsidiary undertakings, Scottish Widows Unit Funds Limited, whereby the subsidiary company can draw down capital from Scottish Widows to finance new business which is reinsured from the parent to its subsidiary. Scottish Widows has also provided subordinated loans to its subsidiary Scottish Widows Annuities Limited and its fellow group undertaking Scottish Widows Bank plc.

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### *Constraints over available capital resources*

Scottish Widows was created following the demutualisation of Scottish Widows Fund and Life Assurance Society in 2000. The terms of the demutualisation are governed by a Court-approved Scheme of Transfer (the Scheme) which, inter alia, created a With-Profits Fund and a Non-Profit Fund and established protected capital support for the with-profits policyholders in existence at the date of demutualisation. Much of that capital support is held in the Non-Profit Fund and, as such, the capital held in that fund is subject to the constraints noted below.

*Requirement to maintain a Support Account.* The Scheme requires the maintenance of a Support Account within the Non-Profit Fund. The quantum of the Support Account is calculated with reference to the value of assets backing current with-profits policies which also existed at the date of demutualisation and must be maintained until the value of these assets reaches a minimum level. Assets can only be transferred from the Non-Profit Fund if the value of the remaining assets in the fund exceeds the value of the Support Account. Scottish Widows has obtained from the FSA permission to include the value of the Support Account in assessing the realistic value of assets available to the With-Profits Fund. At 31 December 2005, the estimated value of surplus admissible assets in the Non-Profit Fund was £2,163 million (31 December 2004: £2,222 million) and the value of the Support Account was £1,115 million (31 December 2004: £1,265 million).

*Further Support Account.* The Further Support Account is an extra tier of capital support for the with-profits policies in existence at the date of demutualisation. The Scheme requires that assets can only be transferred from the Non-Profit Fund if the economic value of the remaining assets in the fund exceeds the aggregate of the Support Account and Further Support Account. Unlike the Support Account test, the economic value used for this test includes both admissible assets and the present value of future profits of business written in the Non-Profit Fund or by any subsidiaries of that fund. The balance of the Further Support Account is expected to reduce to nil by the year 2030. At 31 December 2005, the net economic value of the Non-Profit Fund and its subsidiaries for the purposes of this test was £4,140 million (31 December 2004: £4,185 million) and the combined value of the Support Account and Further Support Account was £2,836 million (31 December 2004: £2,704 million).

*Other restrictions in the Non-Profit Fund.* In addition to the policies which existed at the date of demutualisation, the With-Profits Fund includes policies which have been written since that date. As a result of statements made to policyholders that investment policy will usually be the same for both types of business, there is an implicit requirement to hold additional regulatory assets in respect of the business written after demutualisation. The estimated amount required to provide such support at 31 December 2005 is £267 million (31 December 2004: £300 million). There is a further test requiring that no amounts can be transferred from the Non-Profit Fund of Scottish Widows unless there are sufficient assets within the Long-Term Fund to meet both policyholders' reasonable expectations in light of liabilities in force at a year end and the new business expected to be written over the following year.

### *Movements in regulatory capital*

The primary reasons for the movement in total available capital resources during the year are as follows:

#### *With-Profits Fund*

Available capital in the With-Profits Fund has increased from £1,351 million at 31 December 2004 to an estimated £2,302 million at 31 December 2005 primarily as a result of strong investment market performance.

#### *Non-Profit Fund*

Available capital in the Non-Profit Fund has decreased from £2,222 million at 31 December 2004 to an estimated £2,163 million (excluding the recognition of future profits) at 31 December 2005. This is primarily a result of proposed transfers from the Non-Profit Fund to the Shareholder Fund at the year end of £559 million. One of those proposed transfers relates to an investment in Abbey Life which, following a transfer of capital amounting to £560 million from the Shareholder Fund, was acquired by the Non-Profit Fund during the year at market value and then written down to its regulatory value in accordance with FSA asset valuation rules. The effect of these transactions has to a degree been offset by strong investment return and the emergence of surplus.

#### *Shareholder Fund*

Available capital in the Shareholder Fund has increased from £770 million at 31 December 2004 to an estimated £1,307 million at 31 December 2005. During the year the Shareholder Fund issued £560 million of subordinated debt and, as noted above, transferred this amount into the Non-Profit Fund. This transaction has had no effect on the available capital of the Shareholder Fund. The reason for the increase in available capital is primarily a result of the proposed transfers from the Non-Profit Fund noted above.

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*Financial information calculated on a realistic basis*

The estimated financial position of the With-Profits Fund of Scottish Widows at 31 December 2005, calculated on a realistic basis, is given in the following table, in the form reported to the FSA. As a result of the capital support arrangements, it is considered appropriate to also disclose the realistic financial position of the Long-Term Fund of Scottish Widows as a whole, which consists of both the With-Profits Fund and the Non-Profit Fund.

|  | 31 December 2005        |                      | 31 December 2004        |                      |
|--|-------------------------|----------------------|-------------------------|----------------------|
|  | With-Profits Fund<br>£m | Long-Term Fund<br>£m | With-Profits Fund<br>£m | Long-Term Fund<br>£m |
| Realistic value of assets of fund                      | 19,018                  | 23,242               | 17,814                  | 22,012               |
| Support arrangement assets (value of Support Account ) | 1,115                   |                      | 1,265                   |                      |
| Realistic value of assets available to the fund        | 20,133                  | 23,242               | 19,079                  | 22,012               |
| Realistic value of liabilities of fund                 | (19,253)                | (19,102)             | (18,108)                | (17,827)             |
| <b>Working capital for fund</b>                        | <b>880</b>              | <b>4,140</b>         | 971                     | 4,185                |
| <b>Working capital ratio for fund</b>                  | <b>4.4%</b>             | <b>17.8%</b>         | 5.1%                    | 19.0%                |

Subsequent to finalisation of the accounts, the expected waiver was received from the FSA and the final support arrangement assets in the FSA returns increased to £1,368 million which increased the working capital ratio for the with-profits fund to 5.6 per cent.

Scottish Widows continues to be well capitalised with the working capital ratios for the With-Profits Fund and the Long-Term Fund being an estimated 4.4 per cent (31 December 2004: 5.1 per cent) and 17.8 per cent (31 December 2004: 19.0 per cent) respectively. The decrease in the Long-Term Fund ratio is a result of the proposed transfers to the Shareholder Fund noted above.

The financial information calculated on a realistic basis reconciles to the Capital Statement as follows:

|   | 31 December 2005        |                      |
|---|-------------------------|----------------------|
|   | With-Profits Fund<br>£m | Long-Term Fund<br>£m |
| Available regulatory capital  | 2,302                   | 4,965                |
| Support arrangement assets  | 1,115                   |                      |
| Adjustments to replace statutory liabilities with realistic liabilities   | (2,580)                 | (2,291)              |
| Adjustments to include the value of future profits recognised in respect of Non-Participating business written in the With-Profits Fund | 43                      | 43                   |
| Removal of future profits allowable for regulatory capital purposes   |                         | (500)                |
| Recognition of future profits allowable for realistic capital purposes  |                         | 1,923                |
|   | <b>880</b>              | <b>4,140</b>         |

Analysis of policyholder liabilities in respect of the Group's life assurance business:

Scottish Widows plc



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|   | With-Profits Fund<br>(in accordance<br>with FRS 27)<br>£m | Non-Profit<br>Fund<br>£m | Total long-<br>term fund<br>£m | Other long-<br>term funds<br>£m | Total life<br>business<br>£m |
|---|---|--------------------------|--------------------------------|---------------------------------|------------------------------|
| With-Profits Fund liabilities   | 18,720  |                          | 18,720                         | 133                             | 18,853                       |
| Unit-linked business (excluding those accounted for as<br>investment contracts) |   | 8,041                    | 8,041                          | 2,738                           | 10,779                       |
| Other life assurance business   |   | 8,671                    | 8,671                          | 1,653                           | 10,324                       |
| Insurance and participating investment contract liabilities                     | 18,720  | 16,712                   | 35,432                         | 4,524                           | 39,956                       |
| Non-participating investment contract liabilities                               |   | 14,624                   | 14,624                         | 7,215                           | 21,839                       |
| Total policyholder liabilities  | 18,720  | 31,336                   | 50,056                         | 11,739                          | 61,795                       |

**Capital sensitivities**

*Shareholders funds*

Shareholders funds outside the long-term business fund, other than those used to match regulatory requirements, are mainly invested in assets that are less sensitive to market conditions.

*With-Profits Fund*

The with-profits realistic liabilities and the available capital for the With-Profits Fund are sensitive to both market conditions and changes to a number of non-economic assumptions that affect the valuation of the liabilities of the fund. The available capital resources (and capital requirements) are most sensitive to the level of the stock market, with the position worsening at lower stock market levels as a result of the guarantees to policyholders increasing in value. An increase in the level of equity volatility implied by the market cost of equity put options also increases the market consistent value of the options given to policyholders and worsens the capital position.

The most critical non-economic assumptions are the level of take-up of options inherent in the contracts (higher take up rates are more onerous), mortality rates (lower mortality rates are generally more onerous) and lapses prior to dates at which a guarantee would apply (lower lapse rates are generally more onerous where guarantees are in the money). The sensitivity of the capital position and capital requirements of the With-Profits Fund is partly mitigated by the actions that can be taken by management.

*Other long-term funds*

Outside the With-Profits Fund, assets backing actuarial reserves in respect of policyholder liabilities are invested so that the values of the assets and liabilities are broadly matched. The most critical non-economic assumptions are mortality rates in respect of annuity business written (lower mortality rates are more onerous). The Group has reduced its exposure to deteriorating mortality rates in respect of life assurance contracts through its reinsurance arrangements. In addition, poor cost control would gradually depreciate the available capital and lead to an increase in the valuation of the liabilities (through an increased allowance for future costs).

Assets held in excess of those backing actuarial reserves are invested across a range of investment categories including fixed interest securities, equities, properties and cash. The mix of investments is determined in line with the policy of Lloyds TSB Group to optimise shareholder risk and return. The value of the investments is sensitive to prevailing conditions in the markets selected.

*Options and guarantees*

The Group has sold insurance products that contain options and guarantees, both within the With-Profits Fund and in other funds.

*Options and guarantees within the With-Profits Fund*

The most significant options and guarantees provided from within the With-Profits Fund are in respect of guaranteed minimum cash benefits on death, maturity, retirement or certain policy anniversaries, and guaranteed annuity options on retirement for certain pension policies. For those policies written pre-demutualisation containing potentially valuable options and guarantees, under the terms of the Scheme a separate memorandum account was set up within the With-Profits Fund of Scottish Widows called the Additional Account which is available, inter alia, to meet any additional costs of providing guaranteed benefits in respect of those policies. The Additional Account had a value at 31 December 2005 of £1.7 billion (2004: £1.4 billion). The eventual cost of providing benefits on policies written both pre and post demutualisation is dependent upon a large number of variables, including future interest rates and equity values, demographic factors, such as persistency and mortality, and the proportion of policyholders who seek to exercise their options. The ultimate cost will therefore not be known for many years.

As noted above, under the realistic capital regime of the FSA, the liabilities of the With-Profits Fund are valued using a market-consistent stochastic simulation model. This model is used in order to place a value on the options and guarantees which captures both their intrinsic value and their time value.

The most significant economic assumptions included in the model are:

*Risk-free yield curve.* This is derived from the yield on UK gilts, with an additional 0.1 per cent yield assumed to be risk-free;

*Investment volatility.* This is derived from derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2005, the 10 year equity-implied at-the-money assumption was set at 20.0 per cent (31 December 2004: 18.0 per cent). The long-term at-the-money assumptions for property and fixed interest stocks were 15.0 per cent (31 December 2004: 15.0 per cent) and 13.5 per cent (31 December 2004: 13.0 per cent) respectively.

The model includes a matrix of the correlations between each of the underlying modelled asset types. The correlations used are consistent with long-term historical returns. The most significant non-economic assumptions included in the model are management actions (in respect of investment policy and bonus rates), guaranteed annuity option take up rates and assumptions regarding persistency (both of which are based on recent actual experience), and assumptions regarding mortality (which are based on recent actual experience and industry tables).



*Options and guarantees outside the With-Profits Fund of Scottish Widows*

Abbey Life currently has a number of policies in-force which have a guaranteed annuity option. In total it holds traditional regulatory reserves of £332 million to cover this liability at 31 December 2005 (£288 million at 31 December 2004). These reserves have been determined using prudent future interest rate, mortality rate and rate of annuity option take-up assumptions and exceed the value that would be placed on them using a market-consistent stochastic model. It is estimated that a 0.5 per cent reduction in future interest rates would increase the liability by some £54 million.

Under some of Abbey Life's older contracts, the maturity value or the surrender value at the end of the selected period is guaranteed to be not less than total premiums paid or sums assured. The total provision for these options was £5 million at 31 December 2005 (£11 million at 31 December 2004) and was established using stochastic techniques after making prudent assumptions.

In both Abbey Life and Scottish Widows, certain personal pension policyholders, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme. The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns. There is currently a provision, calculated on a deterministic basis, of £108 million (31 December 2004: £89 million) in respect of those guarantees. If future salary growth were 0.5 per cent per annum greater than assumed, the liability would increase by some £8 million. If yields were 0.5 per cent lower than assumed, the liability would increase by some £19 million.–

**Investment portfolio, maturities, deposits, short-term borrowings**

The tables below have been prepared in accordance with IFRS (for 2004 and 2005) and with UK Generally Accepted Accounting Principles (for 2003) and, as a result, the information included in the tables for 2004 and 2005 is not directly comparable with that for 2003.

**Available-for-sale financial assets and trading securities and other financial assets at fair value through profit or loss (2004: investment securities and other securities)**

The following tables set out the book values and valuations of Lloyds TSB Group's debt securities, treasury and other eligible bills and equity shares at 31 December for each of the three years indicated.

| IFRS   | 2005<br>Book<br>value<br>£m | 2005<br>Valuation<br>£m | 2004<br>Book value<br>£m | 2004<br>Valuation<br>£m |
|--|-----------------------------|-------------------------|--------------------------|-------------------------|
| <b>Available-for-sale financial assets (2004: investment securities)</b> |                             |                         |                          |                         |
| Bank and building society certificates of deposit                        | 1,470                       | 1,470                   | 1,901                    | 1,902                   |
| Corporate debt securities  | 3,036                       | 3,036                   | 2,581                    | 2,587                   |
| Mortgage backed securities   | 4,161                       | 4,161                   | 2,774                    | 2,781                   |
| Other asset backed securities  | 4,981                       | 4,981                   | 3,761                    | 3,756                   |
| Other debt securities  | 29                          | 29                      | 1,140                    | 1,141                   |
| Securities of the US treasury and US government agencies                 | 672                         | 672                     | 1,665                    | 1,666                   |
| Other government securities  | 411                         | 411                     | 546                      | 547                     |
| Other public sector securities   | 47                          | 47                      |                          |                         |
| Treasury bills and other eligible bills                                  | 87                          | 87                      | 88                       | 90                      |
| Equity shares  | 46                          | 46                      | 41                       | 65                      |
|  | <b>14,940</b>               | <b>14,940</b>           | 14,497                   | 14,535                  |

**Trading securities and other financial assets at fair value through profit or loss (2004: other securities)**

|  |               |               |        |        |
|--|---------------|---------------|--------|--------|
| Securities of the US treasury and US government agencies | 186           | 186           | 164    | 164    |
| Other government securities                              | 10,987        | 10,987        | 13,854 | 13,854 |
| Other public sector securities                           | 119           | 119           | 321    | 321    |
| Bank and building society certificates of deposit        | 898           | 898           | 488    | 488    |
| Corporate debt securities                                | 8,881         | 8,881         | 13,445 | 13,445 |
| Mortgage backed securities                               | 236           | 236           | 533    | 533    |
| Other asset backed securities                            | 691           | 691           | 312    | 312    |
| Other debt securities                                    | 4,255         | 4,255         |        |        |
| Treasury bills and other eligible bills                  |               |               | 4      | 4      |
| Equity shares  | 33,505        | 33,505        | 27,269 | 27,269 |
|  | <b>59,758</b> | <b>59,758</b> | 56,390 | 56,390 |

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| UK GAAP  | 2003<br>Book value<br>£m | 2003<br>Valuation<br>£m |
|--|--------------------------|-------------------------|
| <b>Investment securities<sup>1</sup></b>                 |                          |                         |
| Bank and building society certificates of deposit        | 2,515                    | 2,515                   |
| Corporate debt securities                                | 1,895                    | 1,890                   |
| Mortgage backed securities                               | 2,211                    | 2,212                   |
| Other asset backed securities                            | 3,942                    | 3,951                   |
| Other debt securities                                    | 1,283                    | 1,284                   |
| Securities of the US treasury and US government agencies | 1,624                    | 1,626                   |
| Other government securities                              | 271                      | 276                     |
| Equity shares  | 35                       | 131                     |
|  | 13,776                   | 13,885                  |
| <b>Other securities</b>                                  |                          |                         |
| Securities of the US treasury and US government agencies | 38                       | 38                      |
| Other government securities                              | 7,215                    | 7,215                   |
| Other public sector securities                           | 106                      | 106                     |
| Corporate debt securities                                | 6,785                    | 6,785                   |
| Mortgage backed securities                               | 664                      | 664                     |
| Other asset backed securities                            | 120                      | 120                     |
| Equity shares  | 423                      | 423                     |
|  | 15,351                   | 15,351                  |

<sup>1</sup> Investment securities are those intended for use on a continuing basis in the activities of Lloyds TSB Group and not for dealing purposes. Investment securities held by Lloyds TSB Group's insurance businesses are not included in the 2003 disclosures under UK GAAP.

**Maturities and weighted average yields of interest-bearing securities**

The weighted average yield for each range of maturities is calculated by dividing the annualised interest income prevailing at 31 December 2005 by the book value of securities held at that date.

|   | Maturing within one year |            | Maturing after one but within five years |            | Maturing after five but within ten years |            | Maturing after ten years |            |
|---|--------------------------|------------|--|------------|--|------------|--------------------------|------------|
|   | Amount<br>£m             | Yield<br>% | Amount<br>£m                             | Yield<br>% | Amount<br>£m                             | Yield<br>% | Amount<br>£m             | Yield<br>% |
| <b>Available-for-sale financial assets</b>        |                          |            |  |            |  |            |                          |            |
| Bank and building society certificates of deposit | 1,434                    | 4.5        | 36                                       | 3.1        |  |            |                          |            |
| Corporate debt securities                         | 424                      | 7.4        | 1,929                                    | 4.5        | 615                                      | 5.0        | 68                       | 4.7        |
| Mortgage backed securities                        | 126                      | 3.9        | 2,151                                    | 4.9        | 1,726                                    | 4.4        | 158                      | 3.5        |
| Other asset backed securities                     | 564                      | 3.4        | 2,364                                    | 4.7        | 1,294                                    | 4.6        | 759                      | 4.3        |
| Other debt securities                             | 19                       | 3.8        | 4  | 6.3        |  |            | 6                        | 0.6        |
| US treasury and US government agencies            | 26                       | 5.6        | 149                                      | 5.3        | 173                                      | 4.5        | 324                      | 4.4        |
| Other government securities                       | 291                      | 1.5        | 1  | 5.1        |  |            | 119                      | 1.8        |
| Other public sector securities                    | 47                       | 4.6        |  |            |  |            |                          |            |
| Treasury bills                                    | 84                       | 2.5        | 3  | 8.1        |  |            |                          |            |
|   | <b>3,015</b>             |            | <b>6,637</b>                             |            | <b>3,808</b>                             |            | <b>1,434</b>             |            |

**Trading securities and other financial assets at fair value through profit or loss**

|   |              |     |              |     |              |     |               |     |
|---|--------------|-----|--------------|-----|--------------|-----|---------------|-----|
| Bank and building society certificates of deposit | 884          | 4.6 | 14           | 4.7 |              |     |               |     |
| Corporate debt securities                         | 1,002        | 3.4 | 3,802        | 3.9 | 1,228        | 5.0 | 2,849         | 5.4 |
| Mortgage backed securities                        | 20           | 1.7 | 61           | 4.3 | 8            | 5.6 | 147           | 5.7 |
| Other asset backed securities                     |              |     | 50           | 7.1 | 130          | 7.8 | 511           | 5.7 |
| Other debt securities                             | 26           | 3.8 | 362          | 6.3 | 743          | 6.3 | 3,124         | 5.2 |
| US treasury and US government agencies            | 3            |     | 51           | 4.2 | 38           | 4.1 | 94            | 1.3 |
| Other government securities                       | 202          | 4.1 | 1,612        | 4.3 | 3,260        | 4.5 | 5,913         | 3.4 |
| Other public sector securities                    | 3            | 8.0 | 43           | 4.2 |              |     | 73            | 5.4 |
|   | <b>2,140</b> |     | <b>5,995</b> |     | <b>5,407</b> |     | <b>12,711</b> |     |

**Maturity analysis and interest rate sensitivity of loans and advances to customers and banks as at 31 December 2005**

The following table analyses the maturity profile and interest rate sensitivity of loans by type on a contractual repayment basis as at 31 December 2005.

All amounts are before deduction of impairment allowances. Demand loans are included in the maturing in one year or less category.

|  | Maturing in one year or less<br>£m | Maturing after one but within five years<br>£m | Maturing after five years<br>£m | Total<br>£m |
|--|------------------------------------|--|---------------------------------|-------------|
| <b>Domestic</b>                        |                                    |  |                                 |             |
| Loans and advances to banks            | 27,441                             | 1,272  | 146                             | 28,859      |
| Loans and advances to customers:       |                                    |  |                                 |             |
| Mortgages                              | 2,463                              | 11,580   | 74,485                          | 88,528      |
| Other personal lending                 | 8,934                              | 10,969   | 2,873                           | 22,776      |
| Financial, business and other services | 10,451                             | 2,854  | 2,967                           | 16,272      |

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|                             |               |               |               |                |
|-----------------------------|---------------|---------------|---------------|----------------|
| Lease financing             | 804           | 1,455         | 3,556         | 5,815          |
| Hire purchase               | 1,666         | 3,077         | 110           | 4,853          |
| Other                       | 16,140        | 8,703         | 9,110         | 33,953         |
| <b>Total domestic loans</b> | <b>67,899</b> | <b>39,910</b> | <b>93,247</b> | <b>201,056</b> |
| <b>Total foreign loans</b>  | <b>4,902</b>  | <b>910</b>    | <b>1,804</b>  | <b>7,616</b>   |
| <b>Total loans</b>          | <b>72,801</b> | <b>40,820</b> | <b>95,051</b> | <b>208,672</b> |
| Of which:                   |               |               |               |                |
| Fixed interest rate         | 41,214        | 16,813        | 41,507        | 99,534         |
| Variable interest rate      | 31,587        | 24,007        | 53,544        | 109,138        |



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**Deposits**

The following tables show the details of Lloyds TSB Group's average customer deposits in each of the past three years.

| <b>IFRS</b>                           | <b>2005</b><br>Average<br>balance<br>£m | <b>2005</b><br>Average<br>rate<br>% | 2004<br>Average<br>balance<br>£m | 2004<br>Average<br>rate<br>% |
|---------------------------------------|---|-------------------------------------|----------------------------------|------------------------------|
| <b>Deposits in domestic offices</b>   |   |                                     |                                  |                              |
| Non-interest bearing demand deposits  | 3,636                                   |                                     | 3,134                            |                              |
| Interest-bearing demand deposits      | 35,848                                  | 0.52                                | 29,200                           | 0.21                         |
| Savings deposits                      | 53,773                                  | 4.02                                | 49,516                           | 3.63                         |
| Time deposits                         | 28,001                                  | 3.50                                | 26,684                           | 4.15                         |
| <b>Total domestic office deposits</b> | <b>121,258</b>                          | <b>2.75</b>                         | 108,534                          | 2.73                         |
| <b>Deposits in foreign offices</b>    |   |                                     |                                  |                              |
| Non-interest bearing demand deposits  | 267                                     |                                     | 372                              |                              |
| Interest-bearing demand deposits      | 809                                     | 1.11                                | 673                              | 0.89                         |
| Savings deposits                      | 239                                     | 0.84                                | 285                              | 1.05                         |
| Time deposits                         | 1,146                                   | 5.32                                | 1,345                            | 2.30                         |
| <b>Total foreign office deposits</b>  | <b>2,461</b>                            | <b>2.93</b>                         | 2,675                            | 1.50                         |
| <b>Total average deposits</b>         | <b>123,719</b>                          | <b>2.75</b>                         | 111,209                          | 2.70                         |

| <b>UK GAAP</b>                        | 2003<br>Average<br>balance<br>£m | 2003<br>Average<br>rate<br>% |
|---------------------------------------|----------------------------------|------------------------------|
| <b>Deposits in domestic offices</b>   |                                  |                              |
| Non-interest bearing demand deposits  | 2,745                            |                              |
| Interest-bearing demand deposits      | 26,036                           | 0.35                         |
| Savings deposits                      | 47,041                           | 2.82                         |
| Time deposits                         | 24,787                           | 3.47                         |
| <b>Total domestic office deposits</b> | <b>100,609</b>                   | <b>2.27</b>                  |
| <b>Deposits in foreign offices</b>    |                                  |                              |
| Non-interest bearing demand deposits  | 845                              |                              |
| Interest-bearing demand deposits      | 1,608                            | 2.99                         |
| Savings deposits                      | 2,183                            | 4.35                         |
| Time deposits                         | 4,846                            | 6.34                         |
| <b>Total foreign office deposits</b>  | <b>9,482</b>                     | <b>4.75</b>                  |
| <b>Total average deposits</b>         | <b>110,091</b>                   | <b>2.48</b>                  |

**Certificates of deposit and other time deposits**

The following table gives details of Lloyds TSB Group's certificates of deposit issued and other time deposits as at 31 December 2005 individually in excess of US \$100,000 (or equivalent in another currency) by time remaining to maturity.

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|   | 3 months<br>or less<br>£m | Over 3<br>months<br>but within<br>6 months<br>£m | Over 6<br>months<br>but<br>within 12<br>months<br>£m | Over 12<br>months<br>£m | Total<br>£m   |
|---|---------------------------|--|--|-------------------------|---------------|
| <b>Domestic</b>                                 |                           |  |  |                         |               |
| Certificates of deposit                         | 6,657                     | 7,751  | 4,769  | 498                     | 19,675        |
| Time deposits                                   | 27,092                    | 2,043  | 1,405  | 1,032                   | 31,572        |
|   | 33,749                    | 9,794  | 6,174  | 1,530                   | 51,247        |
| <b>Foreign</b>                                  |                           |  |  |                         |               |
| Certificates of deposit and other time deposits | 9,877                     | 887  | 279  | 134                     | 11,177        |
| <b>Total</b>                                    | <b>43,626</b>             | <b>10,681</b>                                    | <b>6,453</b>   | <b>1,664</b>            | <b>62,424</b> |

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**Short-term borrowings**

Short-term borrowings are included within the balance sheet captions Deposits by banks, Customer accounts and Debt securities in issue and are not identified separately on the balance sheet. The short-term borrowings of Lloyds TSB Group consist of overdrafts from banks, securities sold under agreements to repurchase, certificates of deposit issued, commercial paper and promissory notes issued and other marketable paper. Securities sold under agreements to repurchase, certificates of deposit issued and commercial paper and promissory notes are the only significant short-term borrowings of Lloyds TSB Group.

The following tables give details of these significant short-term borrowings of Lloyds TSB Group for each of the past three years.

| IFRS   | 2005<br>£m | 2004<br>£m |
|--|------------|------------|
| <b>Liabilities in respect of securities sold under repurchase agreements</b> |            |            |
| Balance at the year end  | 9,434      | 10,571     |
| Average balance for the year   | 8,706      | 7,112      |
| Maximum balance during the year  | 14,251     | 13,096     |
| Average interest rate during the year  | 4.5%       | 4.5%       |
| Interest rate at the year end  | 4.6%       | 4.6%       |
| <b>Certificates of deposit issued</b>  |            |            |
| Balance at the year end  | 22,101     | 15,226     |
| Average balance for the year   | 22,017     | 17,470     |
| Maximum balance during the year  | 27,376     | 19,287     |
| Average interest rate during the year  | 4.4%       | 3.6%       |
| Interest rate at the year end  | 4.5%       | 4.1%       |
| <b>Commercial paper and promissory notes</b>                                 |            |            |
| Balance at the year end  | 10,421     | 8,026      |
| Average balance for the year   | 8,270      | 6,134      |
| Maximum balance during the year  | 10,421     | 8,026      |
| Average interest rate during the year  | 3.4%       | 2.2%       |
| Interest rate at the year end  | 2.9%       | 3.8%       |

| UK GAAP  | 2003<br>£m |
|--|------------|
| <b>Liabilities in respect of securities sold under repurchase agreements</b> |            |
| Balance at the year end  | 4,640      |
| Average balance for the year   | 4,848      |
| Maximum balance during the year  | 7,395      |
| Average interest rate during the year  | 4.5%       |
| Interest rate at the year end  | 4.0%       |
| <b>Certificates of deposit issued</b>  |            |
| Balance at the year end  | 16,415     |
| Average balance for the year   | 20,663     |
| Maximum balance during the year  | 22,500     |
| Average interest rate during the year  | 3.1%       |
| Interest rate at the year end  | 3.2%       |
| <b>Commercial paper and promissory notes issued</b>                          |            |
| Balance at the year end  | 3,625      |
| Average balance for the year   | 4,635      |
| Maximum balance during the year  | 5,121      |

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|                                       |      |
|---------------------------------------|------|
| Average interest rate during the year | 4.5% |
| Interest rate at the year end         | 1.7% |

**CORPORATE RESPONSIBILITY**

The Lloyds TSB Group's corporate vision is to make Lloyds TSB the best financial services company, firstly in the UK then across borders.

The Lloyds TSB Group's corporate responsibility strategy is to help achieve its corporate vision by building a great place for its people to work, a great place for its customers to do business, and generating great returns for its shareholders. In so doing, the Lloyds TSB Group believes it creates value for all its stakeholders.

The Lloyds TSB Group has strong evidence that there is a clear link between employee satisfaction and customer satisfaction, which in turn leads to improved financial performance.

The business case for corporate responsibility is clear. Good management of corporate responsibility risks and opportunities is fundamental to delivering a successful business.

*A great place for its people to work*

The Lloyds TSB Group seeks its employees' views on working for Lloyds TSB through its Engagement Index, a quarterly survey of all staff. The Lloyds TSB Group knows from many years of monitoring staff views of the company that the six main factors influencing employee engagement are:

providing staff with opportunities for training and development

giving staff the flexibility and scope to use their abilities and initiative

inspiring leadership from top management

the extent to which staff believe Lloyds TSB is highly regarded

creating a culture where people feel involved and understand how their work contributes to the Lloyds TSB Group's overall success

the extent to which the Lloyds TSB Group is seen as being socially and environmentally responsible and ethical in its operations

The Lloyds TSB Group's employee engagement scores have reached record levels this year.

The Lloyds TSB Group's has developed award-winning programmes in the areas of training and development, career management, work-life balance, diversity and community involvement.

*A great place for its customers to do business*

The Lloyds TSB Group is committed to deepening relationships with its customers by understanding and meeting their needs. The Lloyds TSB Group measures its customers' satisfaction with its service and tracks its progress through its CARE Index which is based on information obtained from over 10,000 interviews with customers each month. The CARE Index reached its highest ever level in 2005.

The Lloyds TSB Group also uses mystery shopping programmes to test the levels of service in its branches, via the telephone and on the internet. It uses the Six Sigma process improvement approach to measure how well it meets its customers' requirements.

The Lloyds TSB Group has been at the forefront of developing financial services to help tackle the problems of financial exclusion; these include basic bank accounts, support for community credit unions and other community finance initiatives. The Lloyds TSB Group has opened 348,000 basic bank accounts for customers since 2003.

*A great return for its shareholders*

Through its corporate responsibility management system the Lloyds TSB Group identifies social, ethical and environmental risks and opportunities. The comprehensive policies and processes for managing risks are described in detail on pages 36 to 60 of this report. The Lloyds TSB Group was one of the first UK banks to introduce an environmental risk assessment system for its corporate and business lending. This was described as a race leader in an independent study into European banks' assessment of environmental risks.

Increasingly the Lloyds TSB Group is required to demonstrate its commitment to corporate responsibility to win business contracts. In turn, when awarding contracts to key suppliers it takes account of their performance in areas of human rights, treatment of employees, treatment of

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their own customers and suppliers, the environment and the community. In demanding high ethical standards from its suppliers the Lloyds TSB Group recognises that its own employees must display the highest ethical standards themselves. The Lloyds TSB Group operates to a code of purchasing ethics to ensure fair treatment of suppliers.

By adopting these corporate responsibility policies the Lloyds TSB Group aims to provide a better return for its shareholders.

### *Balanced scorecard*

Staff performance is measured using a balanced scorecard that takes account of the needs of customers, employees and shareholders. All staff have objectives which, in addition to financial performance measures, include building the business in the longer term, customer service, risk management and people development. Where relevant, management remuneration and incentives are linked directly to specific areas of corporate responsibility, such as service quality.

*Corporate responsibility management*

The Lloyds TSB Group's corporate responsibility steering group is chaired by the deputy group chief executive and comprises senior executives from all business divisions and relevant group functions. The committee meets quarterly to recommend strategy and provide direction. The board reviews overall corporate responsibility performance annually and individual issues are subject to board discussion throughout the year.

The Lloyds TSB Group has been developing a management framework for corporate responsibility that ensures it has:

a clear and constant purpose, helping the Lloyds TSB Group to focus on the delivery of results;

a focus on customers and how the Lloyds TSB Group can create value by better meeting their needs;

a systematic application of processes and fact-based assessments to manage the Lloyds TSB Group's business and to make its strategic decisions;

the ability to identify what the Lloyds TSB Group needs to do to develop its people and maximise their potential;

the scope to derive value from meeting the Lloyds TSB Group's responsibilities to the communities it serves.

The Lloyds TSB Group has adopted the European Foundation of Quality Management's Corporate Responsibility Framework. This helps the Lloyds TSB Group align corporate responsibility with business strategy, and also with individual balanced scorecard priorities. As part of the process the Lloyds TSB Group conducts an annual self-assessment of its performance with independent oversight and assurance. This allows the Lloyds TSB Group to identify strengths and areas for improvement and to prioritise actions and objectives. It also provides a benchmark against which the Lloyds TSB Group can compare its performance both internally and externally.

The board believes that the systems in place to manage significant social, ethical and environmental (SEE) risks are effective and provide adequate information to identify and assess the short and long-term risks arising from SEE matters. The board is also satisfied that relevant SEE risks have been assessed during 2005 and that they have been managed in compliance with relevant policies and procedures.

*Creating value in the community*

Continuing to grow a successful business is the best way for Lloyds TSB to create value for all its stakeholders and to contribute to the wider economy. The Lloyds TSB Group is a major employer with nearly 70,000 employees. In 2005, salaries, national insurance, pension contributions and other staff costs totalled £2,855 million and £1,914 million was distributed to shareholders in the form of dividends. When dividends are added to share price appreciation, the Lloyds TSB Group delivered a total return to its shareholders of 10.9 per cent in 2005 and 15.1 per cent in 2004.

Through one of the largest community investment programmes in the UK, the Lloyds TSB Group is able to make a significant contribution to the local communities in which it operates. The majority of Lloyds TSB's charitable giving is channelled through the four Lloyds TSB Foundations, which cover England and Wales, Scotland, Northern Ireland and the Channel Islands. Their mission is to improve the lives of people in local communities, especially those who are disadvantaged or disabled. During 2005, the Foundations distributed £31 million to community causes across the UK.

Community investment is not just about giving money to good causes. It is also about the substantial time given by the Lloyds TSB Group's staff in supporting the work of community organisations, whether raising money, providing business expertise or simply providing another willing pair of hands. One of the Lloyds TSB Group's biggest group wide activities is its Charity of the Year fundraising. In 2005 the Lloyds TSB Group's staff chose to support Marie Curie Cancer Care, raising £1 million to fund 70 Marie Curie nurses for a year.

## MANAGEMENT AND EMPLOYEES

### Directors and senior management

The Group is led by a board comprising executive and non-executive directors with wide experience. The appointment of directors is considered by the board and, following the provisions in the articles of association, they must stand for election by the shareholders at the first annual general meeting following their appointment and must retire, and may stand for re-election by the shareholders, at least every three years. Executive directors normally retire at age 60, as required by their service agreements. Independent non-executive directors are appointed for three-year renewable terms, which may be terminated without notice or payment of compensation.

The board meets at least nine times a year. It has a programme designed to enable the directors regularly to review corporate strategy and the operations and results of the businesses and discharge their duties within a framework of prudent and effective controls relating to the assessing and managing of risk.

The roles of the chairman, the group chief executive and the board and its governance arrangements, including the schedule of matters specifically reserved to the board for decision, are reviewed annually. The matters reserved to the board for decision include the approval of the annual report and accounts and any other financial statements; the payment of dividends; the long-term objectives of the Group; the strategies necessary to achieve these objectives; the Group's budgets and plans; significant capital expenditure items; significant investments and disposals; the basis of allocation of capital within the Group; the organisation structure of the Group; the arrangements for ensuring that the Group manages risks effectively; any significant change in accounting policies or practices; the appointment of the Company's main professional advisers; and the appointment of senior executives within the organisation and the related forward planning.

The board has delegated to management the power to make decisions on operational matters, including those relating to credit, liquidity and market risk, within an agreed framework.

All directors have access to the services of the company secretary, and independent professional advice is available to the directors at the Group's expense, where they judge it necessary to discharge their duties as directors.

The board evaluates its performance and that of its committees and individual directors. The process adopted, using an internally produced questionnaire, affords directors the opportunity, through their membership of boards of other companies, in the UK and overseas, to draw on their experience to endeavour to ensure that the Group follows best practice. It also enables directors to suggest how the board's procedures may be improved; to assess strengths and weaknesses; and to address its balance of skills, knowledge and experience. The committees, themselves, assess their respective roles, performance and terms of reference and report accordingly to the board.

The chairman's performance is evaluated by the non-executive directors, taking account of the views of executive directors. This appraisal is discussed at a meeting of the non-executive directors, led by the senior independent director, without the chairman being present.

The remuneration committee reviews the performance of the chairman, the deputy chairman, the group chief executive and the other group executive directors, when considering their remuneration arrangements. The nomination committee reviews the performance of all the directors. Like all board committees, the nomination committee and remuneration committee report to the board on their deliberations, including the results of these performance evaluations.

The chairman has a private discussion at least once a year with every director on a wide range of issues affecting the Group, including any matters which the directors, individually, wish to raise.

There is an induction programme for all new directors, which is tailored to their specific requirements and includes visits to individual businesses and meetings with senior management. Additional training and updates on particular issues are arranged as appropriate.

In order to develop an understanding of the views of major shareholders, the board receives regular reports from the group finance director and the director of investor relations.

The chairman, the group chief executive and the group finance director also have meetings with representatives of major shareholders and the senior independent director also attends some of these meetings. In addition, all directors are invited to attend investment analysts' and stockbrokers' briefings on the financial results.

All shareholders are encouraged to attend and participate in the Group's annual general meeting.





**Board of directors**

Biographical details of the board of directors are given below.

**Maarten A van den Bergh** ♦♦☿☿

*Chairman*

*(retiring at the annual general meeting on 11 May 2006)*

Joined the board in 2000 as deputy chairman and was appointed chairman in 2001. Joined the Royal Dutch/Shell Group of companies in 1968 and after a number of senior and general management appointments in that group, became group managing director in 1992. Appointed president of Royal Dutch Petroleum Company and vice chairman of the committee of managing directors of the Royal Dutch/Shell Group in 1998 and continued in these roles until 2000. Chairman of supervisory board of Akzo Nobel and a non-executive director of Royal Dutch Shell, BT Group and British Airways. Aged 64.

**Sir Victor Blank**☿☿☿♦♦♦

*Deputy Chairman*

*(succeeding Maarten van den Bergh as chairman)*

Joined the board on 1 March 2006 as deputy chairman. Will succeed Maarten van den Bergh as chairman following the annual general meeting in May 2006. Former partner in Clifford-Turner (now Clifford Chance) from 1969 to 1981 and chairman and chief executive of Charterhouse until 1997. Director of The Royal Bank of Scotland from 1985 to 1993 and Chairman of Trinity Mirror from 1999 to May 2006. Chairman of GUS and a member of the Financial Reporting Council and of the Council of Oxford University. Chairs two charities, WellBeing of Women and UJS Hillel, as well as the Council of University College School. Aged 63.

**Wolfgang C G Berndt** §

Joined the board in 2003. Joined Procter and Gamble in 1967 and held a number of senior and general management appointments in Europe, South America and North America, before retiring in 2001. A non-executive director of Cadbury Schweppes and GfK AG. Board member of the Institute for the Future. Aged 63.

**Ewan Brown** CBE FRSE P \*\* @ ☿

*Chairman of Lloyds TSB Scotland*

Joined the board in 1999. A non-executive director of Lloyds TSB Scotland since 1997. Joined Noble Grossart in 1969 and was an executive director of that company until December 2003. Chairman of tie until May 2006. A non-executive director of John Wood Group until May 2006, Noble Grossart and Stagecoach Group. Aged 64.

**Jan P du Plessis** § \*

Joined the board in October 2005. Chairman of British American Tobacco and RHM. Held a number of senior and general management appointments in Rembrandt Group from 1981, before joining Compagnie Financière Richemont as group finance director in 1988, a position he held until 2004. From 1990 to 1995 he was also the group finance director of Rothmans International. Aged 52.

**Gavin J N Gemmell** CBE § \*

*Chairman of Scottish Widows*

Joined the board in 2002. A non-executive director of Scottish Widows, having been appointed to the board of that company before it became a member of the Lloyds TSB Group. Retired as senior partner of Baillie Gifford in 2001, after 37 years with that firm. A non-executive director of Archangel Informal Investment and tie. Chairman of the Court of Heriot-Watt University. Aged 64.

**Sir Julian Horn-Smith** § ☿

Joined the board in January 2005. Joined Vodafone in 1984 and held a number of senior and general management appointments before being appointed to the board of that company in 1996 and deputy chief executive officer in 2005. Previously held positions in Rediffusion from 1972 to 1978, Philips from 1978 to 1982 and Mars GB from 1982 to 1984. Chairman designate of The Sage Group. A non-executive director of Smiths Group. Aged 57.

**DeAnne S Julius** CBE § @

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Joined the board in 2001. Held a number of senior appointments in the UK and USA with the World Bank, Royal Dutch/Shell Group and British Airways, before membership of the Bank of England Monetary Policy Committee from 1997 to 2001. Chaired HM Treasury's banking services consumer codes review group in 2000/1. Chairman of the Royal Institute of International Affairs. A non-executive director of BP, Serco Group and Roche Holdings SA. Aged 57.

### **Angela A Knight** §\*

Joined the board in 2003. Deputy chairman of Scottish Widows, having been appointed to the board of that company before it became a member of the Lloyds TSB Group. A member of parliament from 1992 to 1997 and Economic Secretary to the

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Treasury from 1995 to 1997. Chief executive of the Association of Private Client Investment Managers and Stockbrokers. A non-executive director of LogicaCMG and the Port of London Authority. Aged 55.

### **Lord Leitch** § \*Ç

Joined the board in October 2005. Held a number of senior and general management appointments in Allied Dunbar, Eagle Star and Threadneedle Asset Management before the merger of Zurich Group and British American Tobacco's financial services businesses in 1998. Subsequently served as chairman and chief executive officer of Zurich Financial Services (UK & Asia Pacific) until his retirement in 2004. Chairman of HM Treasury's Review of Skills and the National Employment Panel, and deputy chairman of the Commonwealth Education Fund. A non-executive director of United Business Media and BUPA. Aged 58.

### *Executive directors*

#### **J Eric Daniels**

*Group Chief Executive*

Joined the board in 2001 as group executive director, UK retail banking before his appointment as group chief executive in June 2003. Served with Citibank from 1975 and held a number of senior and general management appointments in the USA, South America and Europe before becoming chief operating officer of Citibank Consumer Bank in 1998. Following the Citibank/Travelers merger in 1998, he was chairman and chief executive officer of Travelers Life and Annuity until 2000. Chairman and chief executive officer of Zona Financiera from 2000 to 2001. Aged 54.

#### **Michael E Fairey**

*Deputy Group Chief Executive*

Joined TSB Group in 1991 and held a number of senior and general management appointments before being appointed to the board in 1997 and deputy group chief executive in 1998. Joined Barclays Bank in 1967 and held a number of senior and general management appointments, including managing director of Barclays Direct Lending Services from 1990 to 1991. Chairman and President of The British Quality Foundation. Aged 57.

#### **Terri A Dial**

*Group Executive Director, UK Retail Banking*

Joined the board in June 2005. Served with Wells Fargo in the USA from 1973 to 2001 where she held a number of senior and general management appointments before becoming president and chief executive officer of Wells Fargo Bank in 1998. A non-executive director of the LookSmart Corporation and Onyx Software. Aged 56.

#### **Archie G Kane**

*Group Executive Director, Insurance and Investments*

Joined TSB Commercial Holdings in 1986 and held a number of senior and general management appointments in Lloyds TSB Group before being appointed to the board in 2000, as group executive director, IT and operations. Appointed group executive director, insurance and investments in October 2003. After some 10 years in the accountancy profession, joined General Telephone & Electronics Corporation in 1980, serving as finance director in the UK from 1983 to 1985. A member of the board of the Association of British Insurers. Aged 53.

#### **G Truett Tate**

*Group Executive Director, Wholesale & International Banking*

Joined the group in 2003 as managing director, corporate banking before being appointed to the board in 2004. Served with Citigroup from 1972 to 1999, where he held a number of senior and general management appointments in the USA, South America, Asia and Europe. He was president and chief executive officer of eCharge Corporation from 1999 to 2001 and co-founder and vice chairman of the board of Chase Cost Management Inc from 1996 to 2003. Aged 56.

#### **Helen A Weir**

*Group Finance Director*

Joined the board in 2004. Group finance director of Kingfisher from 2000 to 2004. Previously finance director of B&Q from 1997, having joined that company in 1995, and held a senior position at McKinsey & Co from 1990 to 1995. Began her career at Unilever in 1983. A non-executive director of Royal Mail Holdings and a member of the Accounting Standards Board. Aged 43.

- \* Member of the audit committee
- \*\* Chairman of the audit committee
- ® Member of the nomination committee
- ®® Chairman of the nomination committee to 11 May 2006
- ®®® Chairman of the nomination committee from 11 May 2006
- Member of the remuneration committee
- Chairman of the remuneration committee
- + Member of the risk oversight committee
- ++ Chairman of the risk oversight committee to 11 May 2006
- +++ Chairman of the risk oversight committee from 11 May 2006
- § Independent director
- p Senior independent director

## Compensation

### *Role of remuneration committee*

The committee reviews the remuneration policy for the top management group, to ensure that members of the executive management are provided with appropriate incentives to encourage them to enhance the performance of the Group and that they are rewarded for their individual contribution to the success of the organisation. It advises on major changes of employee benefits schemes and it also agrees the policy for authorising claims for expenses from the group chief executive and the chairman. It has delegated power for settling remuneration for the chairman, deputy chairman, the group executive directors, the company secretary and any group employee whose salary exceeds a specified amount.

All the independent non-executive directors are invited to attend meetings if they wish, and they receive the minutes and have the opportunity to comment and have their views taken into account before the committee's decisions are implemented.

The committee's terms of reference are available from the company secretary and are displayed on the Group's website [www.lloydstsb.com](http://www.lloydstsb.com).

### *Directors' remuneration policy*

The Group's remuneration policy is to ensure that individual rewards are aligned with the Group's performance and the interests of its shareholders, and that cost effective packages are provided which attract and retain executive directors and senior management of the highest calibre and motivate them to perform to the highest standards. The main principles are:

FTSE 20 as the comparator group used to benchmark overall competitiveness of the remuneration package whilst taking account of practice within the financial services sector.

The majority of total compensation is linked to the achievement of stretching performance targets.

The long-term rewards are aligned to shareholder interests, which is achieved by taking account of measures that reflect shareholder interests, and by expecting executive directors to build a shareholding in the Group equivalent to 1 times the director's base pay over a period of four years. This has now increased to 1.5 times (2 times for the group chief executive), with the executives being expected to retain at least 50 per cent of all net vested equity until the guideline is met.

The overall package reflects market practice and takes account of the terms and conditions applying to other employees of the Group. As a consequence of the proposed changes in policy, the composition of the remuneration package in 2006 will be as follows:

### **Group chief executive**

#### **Other executive directors**

Basic salary

Cash bonus

Long-term incentives

Pension

**8%**

**23%**

**28%**

**41%**

**9%**

**24%**

**29%**

**38%**

In 2006, approximately 67 per cent (69 per cent for the group chief executive) of an executive director's potential direct remuneration (salary, annual bonus and long-term incentives) will be performance related. The value of long-term incentives is the expected value calculated by using a binomial model, which is a widely accepted methodology for this purpose.

***Chairman's and deputy chairman's remuneration***

The chairman's remuneration comprises a salary and benefits which are broadly similar to the executive directors, but he does not participate in the annual bonus and long-term incentive arrangements.

The chairman's salary is reviewed annually, usually in December, taking into account performance and market information (which is provided by Towers Perrin) and then adjusted from 1 January of the following year. His salary from 1 January 2006 is £500,000 and his pension benefits continue to accrue as described on page 86.

Sir Victor Blank has been appointed as deputy chairman from 1 March 2006 and his salary will be £275,000, increasing to £550,000 on his appointment as chairman in May. He will also receive benefits broadly similar to the executive directors, but he will not participate in the annual bonus, long-term incentive arrangements or be entitled to pension benefits.

**Independent non-executive directors fees**

The fees of the independent non-executive directors are agreed by the board within a total amount determined by the shareholders. An increase in the total amount that can be paid is being proposed at the annual general meeting. Directors may also receive fees, agreed by the board, for membership of board committees. The fees are designed to recognise the various responsibilities of a non-executive director's role and to attract individuals with relevant skills, knowledge and experience. The fees are neither performance related nor pensionable and are comparable with those paid by other companies. The annual fees are listed below:

|                                     |         |
|-------------------------------------|---------|
| Board                               | £50,000 |
| Audit committee chairmanship        | £40,000 |
| Audit committee membership          | £15,000 |
| Nomination committee membership     | £5,000  |
| Remuneration committee chairmanship | £20,000 |
| Remuneration committee membership   | £15,000 |
| Risk oversight committee membership | £15,000 |

Independent non-executive directors who serve on the boards of subsidiary companies may also receive fees from the subsidiaries. These are included in the table shown on page 85.

**Executive director basic salaries**

Basic salaries are reviewed annually, usually in December, taking into account individual performance and market information (which is provided by Towers Perrin) and then adjusted from 1 January of the following year. Basic salary increases for other employees across the Group will be generally in the range of 0-10 per cent, and the salary increase awarded to executive directors are consistent with this policy. Salaries payable from 1 January 2006 are as follows:

| Name   | J E Daniels | M E Fairey | T A Dial | A G Kane | G T Tate | H A Weir |
|--------|-------------|------------|----------|----------|----------|----------|
| Amount | £880,000    | £570,000   | £570,000 | £500,000 | £515,000 | £500,000 |

**Annual incentive scheme**

The annual incentive scheme for executive directors is designed to reflect specific goals linked to the performance of the business.

For executive directors except Mr Daniels, individual bonus awards for 2005 were made from a bonus pool based on group performance with predetermined targets relating to profit before tax and economic profit. The maximum size of the bonus pool applicable to these executives was 100 per cent of the aggregate of their basic salaries, with an amount equal to 75 per cent of their basic salaries payable into the bonus pool on the achievement of a stretching budget; failure to achieve at least 90 per cent of this budget would result in no bonus payment. Executive directors are considered for awards from the bonus pool based on individual targets, contained in a balanced scorecard, which include profitability, franchise growth, risk, service and other specific goals that are relevant to improving overall business performance. These targets are weighted differently for each of the executive directors, reflecting differing strategic priorities. The maximum level of any bonus award distributable from the pool to any individual has been set at 150 per cent of salary for the achievement of exceptional performance targets, to reflect the competitive market position for total earnings opportunity.

From 2006 the current bonus pool arrangement will be discontinued and replaced by an approach based upon individual contribution and overall corporate results. Half of the bonus opportunity will be driven by corporate performance based on the stretching budget and the other half by business unit achievement driven through individual performance based on similar targets to those mentioned above. However, the maximum bonus opportunity will remain 150 per cent for the achievement of exceptional performance targets; an amount equal to 75 per cent of basic salary will continue to be available on the achievement of stretching budget and individual targets. Failure to achieve at least 90 per cent of the stretching budget target would result in no payment under the corporate half of the bonus.

The maximum annual bonus opportunity for 2005 for Mr Daniels was also set at 150 per cent of basic salary for exceptional performance. An amount equal to 112.5 per cent of basic salary is available on the achievement of stretching budget targets relating to profit before tax and economic profit; failure to achieve at least 90 per cent of these performance targets would result in no bonus payment. The actual level of bonus award made takes account of Mr Daniels' individual performance and contribution.





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Regarding Mr Daniels' 2006 bonus opportunity, an amount equal to 112.5 per cent of basic salary will continue to be available on the achievement of stretching targets contained in a balanced scorecard. However, his maximum bonus opportunity will be increased to 175 per cent of basic salary for the achievement of exceptional performance targets, bringing Mr Daniels' bonus opportunity closer to comparator group levels. In line with the revised bonus arrangements for the executive directors, half of the bonus will be driven by corporate results and the other half by individual performance. Failure to achieve at least 90 per cent of the stretching budget target would result in no payment under the corporate half of the bonus.

PricewaterhouseCoopers LLP check the calculation of the annual incentive payments for executive directors based on the achievement of performance against targets set. In respect of performance in 2005, the bonus percentages awarded to the directors are shown in the table below.

### *Performance share plan*

If shareholders approve the policy proposal mentioned earlier, further grants under this scheme will not be awarded to directors after 2006. From 2007, therefore, awards under the annual incentive scheme will be in cash only. However, it is envisaged that the loss of the performance share dynamics under the current plan will be compensated for under the proposed new long-term incentive plan.

Under the performance share plan, executive directors have been required to defer 50 per cent of any bonus payable into shares in the Group, known as bonus shares. The bonus shares are held on behalf of the executive for a period of three years before release. The amount of 2005 bonus deferred into bonus shares before the deduction of income tax was:

| Name           | J E Daniels | M E Fairey | T A Dial | A G Kane | G T Tate | H A Weir |
|----------------|-------------|------------|----------|----------|----------|----------|
| Opportunity    | 150%        | 150%       | 150%     | 150%     | 150%     | 150%     |
| % awarded      | 118.5%      | 79%        | 100%     | 83%      | 111%     | 81%      |
| Deferred bonus | £488,812    | £215,500   | £162,250 | £197,000 | £262,500 | £192,500 |

Under the performance share plan executives will be eligible for an award of free shares, known as performance shares, to match the bonus shares. The maximum match will be two performance shares for each bonus share, awarded at the end of the three year retention period. The number of performance shares actually awarded will depend on the Group's TSR performance measured over the three year period ending December 2008, compared with the TSR of the other companies in the comparator group listed below. The maximum of two performance shares for each bonus share will be awarded only if the Group's TSR performance places it first in the comparator group; one performance share will be awarded for each bonus share if the Group is placed fifth; and one performance share for every two bonus shares if the Group is placed eighth (median). Between first and fifth positions and fifth and eighth positions sliding scales will apply. If the TSR performance is below median no performance shares will be awarded. There will be no retest. Whilst income tax is deducted from the deferred bonus before the conversion to bonus shares, where a match of performance shares is justified, these shares will be awarded as if income tax had not been deducted. This maintains the original design of the plan prior to the issue of guidance from HM Revenue & Customs in December 2004.

Other companies in the comparator group:

|                      |                    |                 |                        |
|----------------------|--------------------|-----------------|------------------------|
| Alliance & Leicester | Aviva              | Banco Santander | Barclays               |
| Bradford & Bingley   | Friends Provident  | HBOS            | HSBC Holdings          |
| Legal & General      | Northern Rock      | Prudential      | Royal Bank of Scotland |
| Royal & Sun Alliance | Standard Chartered |                 |                        |

The remuneration committee believes that the out-performance of the Group's TSR compared with those of the companies in the comparator group will demonstrate the success of the Group's strategy.

### *Long-term rewards - current executive share option scheme*

If the policy proposal mentioned earlier is approved by the shareholders, further options under the current executive option scheme will not be granted to directors in 2006.

In 2005, options were granted to executive directors and senior executives within the scheme limits. These limits relate to the number of shares under option and the price payable on exercise. The maximum limit for the grant of options to an executive director in any one year is equal to 3 times annual basic salary, although in exceptional circumstances, for example on the recruitment of a new executive director, that could be

increased to 4 times annual basic salary.

A performance condition was set when the grant of options was made and the options will not normally be exercisable unless the condition is met. The performance condition requires the Group's ranking, based on TSR over the relevant (three year) period, to be at least eighth within the comparator group.

The full award of options for executive directors will only become exercisable if the Group is ranked within the top four places of the comparator group.

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The comparator group is the same as that used for the performance share plan.

The following table illustrates the percentage of the grant which would be exercisable depending on the Group's TSR ranking within the comparator group set out above.

| Ranking position within comparator group | Per cent of option which may be exercised |
|--|---|
| 1  | 100                                       |
| 2  | 100                                       |
| 3  | 100                                       |
| 4  | 100                                       |
| 5  | 82.5                                      |
| 6  | 65  |
| 7  | 47.5                                      |
| 8  | 30  |
| 9 or below                               | Nil options not exercisable               |

The remuneration committee believes that the out-performance of the Group's TSR compared with those of the companies in the comparator group will demonstrate the success of the Group's strategy. The Group's performance is assessed against the comparator group using data provided by Alithos Limited and PricewaterhouseCoopers LLP checks the results of the testing of the performance conditions.

### *Long-term rewards proposed long-term incentive plan*

Under the proposed long-term incentive plan, awards of shares may be made, with the receipt of shares and the number of shares received subject to the satisfaction of two distinct pre-determined performance conditions, measuring performance of the Group over a three year period. 50 per cent of the award will be based on a condition measuring the Group's TSR against the comparator group. The comparator group will be the same as that used for the current executive share option scheme and performance share plan. In order for the part of the award subject to the TSR condition to vest in full, it will be necessary for the Group's TSR to exceed the median of the TSR of the comparator group by an average of 7.5 per cent per annum. 8.75 per cent of the award will vest where the Group's TSR is equal to median and vesting will occur on a straight line basis in between these points. Where the Group's TSR is below the median of the comparator group, this part of the award will lapse. The remaining 50 per cent will be based on earnings per share (EPS) growth calculated on a compound annualised basis. In order for the award subject to the EPS condition to vest in full, the EPS growth over the performance period must be at least equivalent to an average of the Retail Price Index (RPI) plus 6 per cent per annum. 8.75 per cent of the award will vest where EPS growth is an average of the RPI plus 3 per cent per annum and vesting will occur on a straight line basis in between these points. Where the EPS growth is less than an average of the RPI plus 3 per cent per annum this part of the award will lapse. Awards in any one financial year will not normally exceed three times basic salary at the time of award. In exceptional circumstances this may be increased to up to four times basic salary. Awards will lapse at the end of the performance period to the extent that the performance conditions have not been satisfied. There will be no retesting. The aim of the plan is to deliver shareholder value through linking the receipt of shares to an improvement in the performance of the Group over a three year period.

### *Other share plans*

The executive directors and the chairman are also eligible to participate in the Group's sharesave scheme and the Group's shareplan. These are all-employee share schemes and performance conditions do not apply.

### *Dilution limits*

The following charts illustrate the shares available for the Group's share schemes.

(10% in any consecutive 10 years)

**All schemes**

**Executive schemes**

(5% in any consecutive 10 years)

Shares used (million)

Shares available (million)

**Pensions**

Executive directors are either entitled to participate in the Group's defined benefit pension schemes (based on salary and length of service, with a maximum pension of two thirds of final salary), or the Group's defined contribution scheme (under which their final entitlement will depend on their contributions and the final value of their fund). The defined benefit schemes are closed to new entrants on recruitment.

**Service agreements**

The Group's policy is for executive directors to have service agreements with notice periods of no more than one year. All current executive directors are entitled to receive 12 months' notice from the Group, but would be required to give six months' notice if they wished to leave. The current chairman, Mr van den Bergh, retires at the annual general meeting and the notice period for his successor, Sir Victor Blank, is shown in the table below.

Independent non-executive directors do not have service agreements and, in accordance with the articles of association, their appointment may be terminated at any time without compensation.

It is the Group's policy that where compensation on early termination is due, it should be paid on a phased basis, mitigated in the event that alternative employment is secured, and that bonus payments should relate to the period of actual service, rather than the full notice period and will be determined on the basis of performance.

Any entitlements under the pension scheme or equity plans will be in accordance with the scheme rules on leaving.

|                  | Notice to be given by the Company | Date of service agreement/letter of appointment |
|------------------|-----------------------------------|---|
| Sir Victor Blank | 6 months                          | 25 January 2006                                 |
| J E Daniels      | 12 months                         | 19 October 2001                                 |
| M E Fairey       | 12 months                         | 28 August 1991                                  |
| T A Dial         | 12 months                         | 23 May 2005                                     |
| A G Kane         | 12 months                         | 9 February 2000                                 |
| G T Tate         | 12 months                         | 29 July 2004                                    |
| H A Weir         | 12 months                         | 4 March 2004                                    |

**External appointments**

The Group recognises that executive directors may be invited to become non-executive directors of other companies and that these appointments may broaden their knowledge and experience, to the benefit of the Group. Fees are normally retained by the individual directors as the post entails personal responsibility. Executive directors are generally allowed to accept one non-executive directorship.

During 2005, Ms Dial and Mrs Weir received fees of \$88,775 and £14,375 respectively, which were retained by them, for serving as non-executive directors of other companies.

**Performance graph**

The graph illustrates the performance of the Group measured by TSR against a broad equity market index over the past five years. As the Group has been a constituent of the FTSE 100 index throughout this five-year period, that index is considered to be the most appropriate benchmark.

Comparative TSR

31 Dec

31 Dec

31 Dec

31 Dec

31 Dec

31 Dec

2000

2001

2002

2003

2004

2005

Lloyds TSB Group plc

FTSE 100 Index

Rebased to 100 on 31 December 2000

*Source: Datastream*

120

100

80

60

40

20

0

84

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*Directors' emoluments for 2005*

|   | Salaries/<br>fees<br>£000 | Other benefits |                  | Performance-<br>related<br>payments<br>£000 | Compensation<br>for loss of<br>office<br>£000 | 2005<br>Total<br>£000 | 2004<br>Total<br>£000 |
|---|---------------------------|----------------|------------------|---|---|-----------------------|-----------------------|
|   |                           | Cash<br>£000   | Non cash<br>£000 |   |   |                       |                       |
| <b>Current directors who served during 2005</b> |                           |                |                  |   |   |                       |                       |
| <b>Executive directors</b>                      |                           |                |                  |   |   |                       |                       |
| J E Daniels                                     | 825                       | 100            | 3                | 1,002                                       |   | 1,930                 | 1,903                 |
| M E Fairey                                      | 545                       | 462            | 8                | 447   |   | 1,462                 | 1,478                 |
| T A Dial  | 321                       | 222            |                  | 334   |   | 877                   |                       |
| A G Kane  | 475                       | 18             | 18               | 408   |   | 919                   | 858                   |
| G T Tate  | 475                       | 52             | 9                | 539   |   | 1,075                 | 403                   |
| H A Weir  | 475                       | 73             | 16               | 399   |   | 963                   | 654                   |
| <b>Non-executive directors</b>                  |                           |                |                  |   |   |                       |                       |
| M A van den Bergh                               | 475                       | 12             |                  |   |   | 487                   | 454                   |
| W C G Berndt                                    | 67                        |                |                  |   |   | 67                    | 55                    |
| Ewan Brown                                      | 122                       |                |                  |   |   | 122                   | 84                    |
| J P du Plessis                                  | 16                        |                |                  |   |   | 16                    |                       |
| G J N Gemmell                                   | 121                       |                |                  |   |   | 121                   | 110                   |
| Sir Julian Horn-Smith                           | 74                        |                |                  |   |   | 74                    |                       |
| D S Julius                                      | 66                        |                |                  |   |   | 66                    | 55                    |
| A A Knight                                      | 105                       |                |                  |   |   | 105                   | 93                    |
| Lord Leitch                                     | 16                        |                |                  |   |   | 16                    |                       |
| <b>Former directors who served during 2005</b>  |                           |                |                  |   |   |                       |                       |
| P G Ayliffe                                     | 33                        | 2              |                  |   | 366   | 401                   | 588                   |
| C S Gibson-Smith                                | 21                        |                |                  |   |   | 21                    | 55                    |
| D P Pritchard                                   | 88                        | 4              | 5                | 3   |   | 100                   | 279                   |
| <b>Former directors who served during 2004</b>  |                           |                |                  |   |   |                       |                       |
| P R Hampton                                     |                           |                |                  |   | 4   | 4                     | 359                   |
| Others  |                           |                |                  |   |   |                       | 1,050                 |
|   | <b>4,320</b>              | <b>945</b>     | <b>59</b>        | <b>3,132</b>                                | <b>370</b>                                    | <b>8,826</b>          | <b>8,478</b>          |

Mr Fairey waived fees payable to him as a director of Lloyds TSB Group Pension Trust (No.1) Limited and Lloyds TSB Group Pension Trust (No.2) Limited, which totalled £10,000 in 2005 (2004: £nil).

Mr Brown waived fees payable to him as a director and chairman of Lloyds TSB Group Pension Trust (No.1) Limited and Lloyds TSB Group Pension Trust (No.2) Limited, which totalled £14,000 in 2005 (2004: £nil).

Mr Pritchard left the board on 5 May 2005 but remained a director of Scottish Widows Group and received fees of £26,667 from that company for the period May until December.

The cash column under 'other benefits' includes flexible benefits payments (4 per cent of basic salary), the tax planning allowances for Mr Daniels and Ms Dial, the housing allowance, relocation allowance and pension scheme allowance for Ms Dial, payments to certain directors who elect to take cash rather than a company car under the car scheme, cash balance of pension allowance for Mr Tate and Mrs Weir and an additional payment in respect of the contribution to the separate fund relating to Mr Fairey's pension. The separate fund, which was mentioned in previous annual reports, was established to cover pension obligations of those who joined the Group after 1 June 1989 and who are subject to the Inland Revenue cap relating to pensions, introduced by the Finance Act 1989.

The non cash column includes amounts relating to the use of a company car, use of a company driver and private medical insurance. It also includes the value of any matching shares which are received under the terms of shareplan, through which employees have the opportunity to purchase shares up to a maximum of £125 per month and receive matching shares on a one for one basis up to a maximum value of £30 per month, rounded down to the nearest whole share.



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Performance-related payments relate to cash bonuses based on Group performance and the attainment of pre-determined targets relating to profit before tax and economic profit. These payments also include the value of any award made under shareplan, the first £3,000 of which is made in the form of shares in Lloyds TSB Group plc.

Mr Ayliffe left the board on 31 January 2005. However, he remained with the Company until his employment was terminated on 31 March 2005 and was paid £71,442 for that period. Mr Hampton's employment was terminated on 12 January 2004. Subsequently they both received payments in accordance with their contractual entitlement.

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### *Directors' pensions*

The executive directors are members of one of the pension schemes provided by Lloyds TSB Group with benefits either on a defined benefit or defined contribution basis. Those directors who joined Lloyds TSB Group after 1 June 1989 and are members of a defined benefit scheme, have pensions provided on salary in excess of the earnings cap either through membership of a funded unapproved retirement benefits scheme ( FURBS ) or by an unfunded pension promise.

Retirement pensions accrue at rates of between 1/60 and 1/30 of basic salary per annum.

Directors have a normal retirement age of 60. In the event of death in service, a lump sum of four times salary is payable plus, for members of a defined benefit scheme, a spouse's pension of two-thirds of the member's prospective pension. On death in retirement, a spouse's pension of two-thirds of the member's pension is payable. The defined benefit schemes are non-contributory. Members of defined contribution schemes are required to contribute.

Ms Dial elected to become a member of a pension scheme for life cover only. She joined Lloyds TSB Group on 1 June 2005. She receives a salary supplement of 20 per cent of basic pay as an alternative to an employer contribution to a pension scheme.

### *Defined contribution scheme members*

Mr Tate is a member of a defined contribution scheme. During the year to 31 December 2005, the employer has made contributions to the defined contribution scheme in respect of him totalling £62,937.

Mrs Weir is a member of a defined contribution scheme. During the year to 31 December 2005, the employer has made contributions to the defined contribution scheme in respect of her totalling £40,375.

### *Defined benefit scheme members*

|  | <b>Accrued<br/>pension at<br/>31 December<br/>2005<br/>£000<br/>(a)</b> | Accrued<br>pension at<br>31 December<br>2004<br>£000<br>(b) | Change in<br>accrued<br>pension<br>£000<br>(a)-(b) | <b>Transfer<br/>value at<br/>31 December<br/>2005<br/>£000<br/>(c)</b> | Transfer<br>value at<br>31 December<br>2004<br>£000<br>(d) | Change in<br>transfer<br>value<br>£000<br>(c)-(d) | <b>Additional<br/>pension<br/>earned to<br/>31 December<br/>2005<br/>£000<br/>(e)</b> | Transfer<br>value of the<br>increase<br>£000<br>(f) |
|--|---|---|--|--|--|---|---|---|
| P G Ayliffe  | 139   | 132   | 7  | 2,045  | 1,780  | 265   | 3   | 46  |
| J E Daniels  | 99  | 77  | 22   | 1,599  | 1,139  | 460   | 19  | 309   |
| M E Fairey   | 256   | 226   | 30   | 5,003  | 3,996  | 1,007   | 23  | 449   |
| A G Kane   | 240   | 216   | 24   | 3,700  | 3,039  | 661   | 17  | 264   |
| In addition, the following unfunded benefits have accrued for Mr van den Bergh instead of a salary increase in 2002: |   |   |  |  |  |   |   |   |
| M A van den Bergh  | 13  | 10  | 3  | 190  | 136  | 54  | 3   | 40  |

Mr Ayliffe's pension entitlement at 31 December 2005 includes additional service in respect of his notice period in accordance with the terms of his contract.

The disclosures in columns (a) to (d) are as required by the Companies Act 1985 Schedule 7A.

Columns (a) and (b) represent the deferred pension to which the directors would have been entitled had they left the Group on 31 December 2005 and 2004, respectively (ignoring the two-year requirement to qualify for a deferred pension).

Column (c) is the transfer value of the deferred pension in column (a) calculated as at 31 December 2005 based on factors supplied by the actuary of the relevant Lloyds TSB Group pension scheme in accordance with actuarial guidance note GN11. The underlying bases used to arrive at the factors have not changed during the year.

Column (d) is the equivalent transfer value, but calculated as at 31 December 2004 on the assumption that the director left service at that date.

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Column (e) is the increase in pension built up during the year, recognising (i) the accrual rate for the additional service based on the pensionable salary in force at the year end, and (ii) where appropriate the effect of pay changes in real (inflation adjusted) terms on the pension already earned at the start of the year.

Column (f) is the capital value of the pension in column (e).

The disclosures in columns (e) and (f) are as required by the UK Listing Authority listing rules. The requirements of the listing rules differ from those of the Companies Act. The listing rules require the additional pension earned over the year to be calculated as the difference between the pension accrued at the end of the financial year and the pension accrued at the start of the financial year less the increase in the pension earned over the year solely due to inflation. The transfer value in column (f) can differ significantly from the change in transfer value as required by the Companies Act because the additional pension accrued over the year calculated in accordance with the listing rules makes allowance for inflation and the change in the transfer value required by the Companies Act will be significantly influenced by changes in the assumptions underlying the transfer value calculation at the beginning and end of the financial year.

Members of Lloyds TSB Group's pension schemes have the option to pay additional voluntary contributions: neither the contributions nor the resulting benefits are included in the above table.

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Share ownership

Directors interests

The interests, all beneficial, of those who were directors at 31 December 2005 in shares in Lloyds TSB Group were:

| Shares                         | At 1 January 2005<br>(or later date of<br>appointment) | At 31<br>December<br>2005 |
|--------------------------------|--|---------------------------|
| <b>Executive directors</b>     |  |                           |
| J E Daniels                    | 38,136   | 160,942                   |
| M E Fairey                     | 77,858   | 79,104                    |
| T A Dial                       |  |                           |
| A G Kane                       | 98,979   | 100,101                   |
| G T Tate                       | 701  | 1,356                     |
| H A Weir                       | 1,699  | 3,992                     |
| <b>Non-executive directors</b> |  |                           |
| M A van den Bergh              | 5,079  | 5,098                     |
| W C G Berndt                   | 46,000   | 61,000                    |
| Ewan Brown                     | 4,027  | 4,260                     |
| J P du Plessis                 |  | 10,000                    |
| G J N Gemmell                  | 70,000   | 70,000                    |
| Sir Julian Horn-Smith          | 5,000  | 5,000                     |
| D S Julius                     | 2,000  | 2,000                     |
| A A Knight                     | 4,940  | 4,940                     |
| Lord Leitch                    |  |                           |

Non-beneficial interests

Directors had non-beneficial interests as follows:

Mr Daniels, Mr Fairey, Ms Dial, Mr Kane, Mr Tate, Mr van den Bergh and Mrs Weir, together with some 77,000 other employees, were potential beneficiaries in the 1,364 and 1,237,191 shares held at the end of the year by the Lloyds TSB qualifying employee share ownership trust and the Lloyds TSB Group employee share ownership trust respectively. 1,364 and 1,467,422 shares, respectively, were held by these trusts at the beginning of the year. In addition, the above directors, with the exception of Mr van den Bergh, together with some 77,000 other employees, were potential participants in shareplan and were, therefore, treated as interested in the 582,462 shares held at the end of the year by the trustee of the shareplan. 471,989 shares were held by the trustee at the beginning of the year.

Interests in share options

| Current directors<br>who served<br>during 2005 | At 1 January 2005<br>(or later date of<br>appointment) | Granted<br>during<br>the year | Exercised/<br>lapsed during<br>the year | At 31<br>December<br>2005 | Exercise<br>price | Exercise periods |            | Notes |
|--|--|-------------------------------|---|---------------------------|-------------------|------------------|------------|-------|
|  |  |                               |   |                           |                   | From             | To         |       |
| J E Daniels                                    | 907,780  |                               | 907,780                                 |                           | 694p              | 1/11/2004        | 31/10/2011 | d,j   |
|  | 330,419  |                               |   | 330,419                   | 715p              | 6/3/2005         | 5/3/2012   | d,g   |
|  | 3,327  |                               |   | 3,327                     | 284p              | 1/6/2006         | 30/11/2006 | a,h   |
|  | 599,239  |                               |   | 599,239                   | 394.25p           | 21/2/2006        | 20/2/2013  | d,h   |
|  | 305,232  |                               |   | 305,232                   | 430p              | 14/8/2006        | 13/8/2013  | d,h   |
|  | 939,177  |                               |   | 939,177                   | 419.25p           | 18/3/2007        | 17/3/2014  | d,h   |
|  |  | 521,876                       |   | 521,876                   | 474.25p           | 17/3/2008        | 16/3/2015  | e,h   |
| M E Fairey                                     | 797  |                               |   | 797                       | 474p              | 1/11/2005        | 30/4/2006  | a,f   |
|  | 54,000   |                               |   | 54,000                    | 510p              | 26/3/2000        | 25/3/2007  | b,f   |
|  | 48,000   |                               |   | 48,000                    | 859.5p            | 15/5/2001        | 14/5/2008  | b,f   |

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|                |                |         |           |            |     |
|----------------|----------------|---------|-----------|------------|-----|
| 57,000         | <b>57,000</b>  | 817p    | 2/8/2002  | 1/8/2009   | b,g |
| 85,896         | <b>85,896</b>  | 549.5p  | 6/3/2003  | 5/3/2010   | c,g |
| 10,931         | <b>10,931</b>  | 615.5p  | 8/8/2003  | 7/8/2010   | c,g |
| 42,884         | <b>42,884</b>  | 655p    | 6/3/2004  | 5/3/2011   | c,g |
| 148,618        | <b>148,618</b> | 733p    | 21/8/2004 | 20/8/2011  | d,j |
| 345,104        | <b>345,104</b> | 715p    | 6/3/2005  | 5/3/2012   | d,g |
| 1,330          | <b>1,330</b>   | 284p    | 1/6/2006  | 30/11/2006 | a,h |
| 531            | <b>531</b>     | 348p    | 1/11/2006 | 30/4/2007  | a,h |
| 663,157        | <b>663,157</b> | 394.25p | 21/2/2006 | 20/2/2013  | d,h |
| 555,992        | <b>555,992</b> | 419.25p | 18/3/2007 | 17/3/2014  | d,h |
| <b>344,754</b> | <b>344,754</b> | 474.25p | 17/3/2008 | 16/3/2015  | e,h |
| T A Dial       | <b>464,134</b> | 474p    | 11/8/2008 | 10/8/2015  | e,h |

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Interests in share options (continued)

| Current directors who served during 2005       | At 1 January 2005 (or later date of appointment) | Granted during the year | Exercised/lapsed during the year | At 31 December 2005 (or earlier date of leaving the board) | Exercise price | Exercise periods |            | Notes     |     |
|--|--|-------------------------|----------------------------------|--|----------------|------------------|------------|-----------|-----|
|  |  |                         |                                  |  |                | From             | To         |           |     |
| A G Kane                                       | 25,000   |                         |                                  | <b>25,000</b>  | 321p           | 28/3/1999        | 27/3/2006  | b,f       |     |
|  | 40,000   |                         |                                  | <b>40,000</b>  | 510p           | 26/3/2000        | 25/3/2007  | b,f       |     |
|  | 50,000   |                         |                                  | <b>50,000</b>  | 880p           | 4/3/2001         | 3/3/2008   | b,f       |     |
|  | 27,000   |                         |                                  | <b>27,000</b>  | 887.5p         | 4/3/2002         | 3/3/2009   | b,g       |     |
|  | 64,786   |                         |                                  | <b>64,786</b>  | 549.5p         | 6/3/2003         | 5/3/2010   | c,g       |     |
|  | 11,841   |                         |                                  | <b>11,841</b>  | 615.5p         | 8/8/2003         | 7/8/2010   | c,g       |     |
|  | 34,759   |                         |                                  | <b>34,759</b>  | 655p           | 6/3/2004         | 5/3/2011   | c,g       |     |
|  | 118,178  |                         | <b>118,178</b>                   |  | 733p           | 21/8/2004        | 20/8/2011  | d,j       |     |
|  | 275,349  |                         |                                  | <b>275,349</b>   | 715p           | 6/3/2005         | 5/3/2012   | d,g       |     |
|  | 5,783  |                         |                                  | <b>5,783</b>   | 284p           | 1/6/2008         | 30/11/2008 | a,h       |     |
|  | 529,105  |                         |                                  | <b>529,105</b>   | 394.25p        | 21/2/2006        | 20/2/2013  | d,h       |     |
|  | 523,255  |                         |                                  | <b>523,255</b>   | 419.25p        | 18/3/2007        | 17/3/2014  | d,h       |     |
|  |  |                         | <b>300,474</b>                   |  | <b>300,474</b> | 474.25p          | 17/3/2008  | 16/3/2015 | e,h |
| G T Tate                                       | 348,837  |                         |                                  | <b>348,837</b>   | 430p           | 14/8/2006        | 13/8/2013  | d,h       |     |
|  | 268,336  |                         |                                  | <b>268,336</b>   | 419.25p        | 18/3/2007        | 17/3/2014  | d,h       |     |
|  | 195,409  |                         |                                  | <b>195,409</b>   | 403p           | 12/8/2007        | 11/8/2014  | d,h       |     |
|  |  |                         | <b>300,474</b>                   |  | <b>300,474</b> | 474.25p          | 17/3/2008  | 16/3/2015 | e,h |
| H A Weir                                       | 556,208  |                         |                                  | <b>556,208</b>   | 424.75p        | 29/4/2007        | 28/4/2014  | d,h       |     |
|  | 5,093  |                         |                                  | <b>5,093</b>   | 321p           | 1/11/2009        | 30/4/2010  | a,h       |     |
|  |  |                         | <b>300,474</b>                   |  | <b>300,474</b> | 474.25p          | 17/3/2008  | 16/3/2015 | e,h |
| Other share plans:                             |  |                         |                                  |  |                |                  |            |           |     |
| J E Daniels                                    | 216,763  |                         | <b>216,763</b>                   |  | (see page 90)  |                  |            | i         |     |
| T A Dial                                       |  | <b>242,825</b>          |                                  | <b>242,825</b>   |                | 1/6/2008         | 30/11/2008 | h         |     |
| <b>Former directors who served during 2005</b> |  |                         |                                  |  |                |                  |            |           |     |
| P G Ayliffe                                    | 3,327  |                         |                                  | <b>3,327*</b>  | 284p           | 1/6/2006         | 30/11/2006 | a         |     |
|  | 13,000   |                         |                                  | <b>13,000</b>  | 321p           | 28/3/1999        | 27/3/2006  | b,f       |     |
|  | 12,000   |                         |                                  | <b>12,000</b>  | 510p           | 26/3/2000        | 25/3/2007  | b,f       |     |
|  | 20,000   |                         |                                  | <b>20,000</b>  | 880p           | 4/3/2001         | 3/3/2008   | b,f       |     |
|  | 3,000  |                         |                                  | <b>3,000</b>   | 887.5p         | 4/3/2002         | 3/3/2009   | b,g       |     |
|  | 23,657   |                         |                                  | <b>23,657</b>  | 549.5p         | 6/3/2003         | 5/3/2010   | c,g       |     |
|  | 10,560   |                         |                                  | <b>10,560</b>  | 615.5p         | 8/8/2003         | 7/8/2010   | c,g       |     |
|  | 16,717   |                         |                                  | <b>16,717</b>  | 655p           | 6/3/2004         | 5/3/2011   | c,g       |     |
|  | 44,562   |                         |                                  | <b>44,562</b>  | 733p           | 21/8/2004        | 20/8/2011  | d,k       |     |
|  | 104,895  |                         |                                  | <b>104,895</b>   | 715p           | 6/3/2005         | 5/3/2012   | d,g       |     |
|  | 218,769  |                         | <b>60,770*</b>                   |  | <b>157,999</b> | 394.25p          | 21/2/2006  | 20/2/2013 | d,h |
|  | 177,034  |                         | <b>78,682*</b>                   |  | <b>98,352</b>  | 430p             | 14/8/2006  | 13/8/2013 | d,h |
|  | 429,338  |                         | <b>274,300*</b>                  |  | <b>155,038</b> | 419.25p          | 18/3/2007  | 17/3/2014 | d,h |
| D P Pritchard                                  | 50,000   |                         |                                  | <b>50,000</b>  | 859.5p         | 15/5/2001        | 14/5/2008  | b,f       |     |
|  | 40,000   |                         |                                  | <b>40,000</b>  | 817p           | 2/8/2002         | 1/8/2009   | b,g       |     |
|  | 71,519   |                         |                                  | <b>71,519</b>  | 549.5p         | 6/3/2003         | 5/3/2010   | c,g       |     |
|  | 10,385   |                         |                                  | <b>10,385</b>  | 615.5p         | 8/8/2003         | 7/8/2010   | c,g       |     |
|  | 36,374   |                         |                                  | <b>36,374</b>  | 655p           | 6/3/2004         | 5/3/2011   | c,g       |     |

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|         |                |      |           |           |     |
|---------|----------------|------|-----------|-----------|-----|
| 127,131 | <b>127,131</b> | 733p | 21/8/2004 | 20/8/2011 | d,k |
| 286,363 | <b>286,363</b> | 715p | 6/3/2005  | 5/3/2012  | d,g |

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- a) Sharesave.
- b) Executive option granted between March 1996 and August 1999.
- c) Executive option granted between March 2000 and March 2001.
- d) Executive option granted between August 2001 and August 2004.
- e) Executive option granted from March 2005.
- f) Exercisable.
- g) Not exercisable as the performance conditions had not been met.
- h) Not exercisable as the option has not been held for the period required by the relevant scheme.
- i) Market price on day of exercise was 497p. In that regard Mr Daniels made a gain of £1,077,312. This is the difference between the market price of the shares on the day on which the share option was exercised and the price paid for the shares.
- j) These share options lapsed as the performance condition had not been met.
- k) These share options lapsed after Mr Ayliffe and Mr Pritchard left the board as the performance condition had not been met.  
 Mr Ayliffe exercised this share option after he left the board. The date of exercise was 14 December 2005 and the market price of the shares on that day was 480.25p.
- \* These share options lapsed when Mr Ayliffe left the board.

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*Interests in share options (continued)*

*Lloyds TSB performance share plan*

The following bonus and performance shares relating to the bonus award for 2004 are available under the plan. Further information is given on page 82.

|             | Bonus shares      |                           |                     | Performance shares |   |                     | Award price | Bonus shares release and performance share award date |
|-------------|-------------------|---------------------------|---------------------|--------------------|---|---------------------|-------------|---|
|             | At 1 January 2005 | Purchased during the year | At 31 December 2005 | At 1 January 2005  | Conditional award during the year (maximum) | At 31 December 2005 |             |   |
| J E Daniels |                   | 57,737                    | 57,737              |                    | 195,720                                     | 195,720             | 479p        | 18/3/2008   |
| M E Fairey  |                   | 31,901                    | 31,901              |                    | 108,140                                     | 108,140             | 479p        | 18/3/2008   |
| A G Kane    |                   | 22,171                    | 22,171              |                    | 75,156                                      | 75,156              | 479p        | 18/3/2008   |
| G T Tate    |                   | 22,710                    | 22,710              |                    | 76,982                                      | 76,982              | 479p        | 18/3/2008   |
| H A Weir    |                   | 16,628                    | 16,628              |                    | 56,366                                      | 56,366              | 479p        | 18/3/2008   |

The market price for a share in the Company at 1 January 2005 and 31 December 2005 was 473p and 488.5p, respectively. The range of prices between 1 January 2005 and 31 December 2005 was 439.5p to 509p.

None of the other directors at 31 December 2005 had options to acquire shares in Lloyds TSB Group plc or its subsidiaries.

The following table contains information on the performance conditions for executive options granted since 1996. The remuneration committee chose the relevant performance condition because it was felt to be challenging, aligned to shareholders' interests and appropriate at the time.

| Options granted           | Performance conditions  |
|---------------------------|---|
| Prior to March 1996       | None  |
| March 1996                | Growth in earnings per share which is equal to the aggregate percentage change in the retail price index plus two percentage points for each complete year of the relevant period.  |
| March 1997 – August 1999  | As for March 1996 plus a further condition that the Company's ranking based on TSR over the relevant period should be in the top fifty companies of the FTSE 100.   |
| March 2000 – March 2001   | As for March 1997 – August 1999 except that there must have been growth in the earnings per share equal to the change in the retail price index plus three percentage points for each complete year of the relevant period.   |
| August 2001 – August 2004 | That the Company's ranking based on TSR over the relevant period against a comparator group (17 UK and international financial services companies including Lloyds TSB Group) must be at least ninth, when 14 per cent of the option will be exercisable. If the company is ranked first in the group, then 100 per cent of the option will be exercisable and if ranked tenth or below the performance condition is not met.<br><br>At the end of 2005 Lloyds TSB Group was ranked:<br>15th after four years of the performance period for options granted in 2002;<br>17th after three years of the performance period for options granted in 2003; and<br>8th after two years of the performance period for the options granted in 2004.<br>Options granted in 2001 lapsed as the performance conditions had not been met. |
| March 2005 – August 2005  | That the Company's ranking based on TSR over the relevant period against a comparator group (15 companies including Lloyds TSB Group) must be at least eighth, when 30 per cent of the option will be exercisable. If the company is ranked first to fourth position in the group, then 100 per cent of the option  |



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will be exercisable and if ranked ninth or below the performance condition is not met.  
At the end of 2005 Lloyds TSB Group was ranked 10th after one year of the performance period.

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***Other share plans***

***Share retention plan***

Mr Daniels was the only participant in this plan and held an option, granted to him on 2 November 2001, to acquire 216,763 ordinary shares in Lloyds TSB Group plc for a total price of £1. The option was granted as part of the remuneration package considered necessary to attract him from the USA and was designed to encourage him to remain with Lloyds TSB Group plc. The option was not subject to any performance condition and vested on 31 December 2004. Mr Daniels exercised this option on 4 March 2005. Full details of the plan were set out in the 2002 annual report on Form 20-F.

***Lloyds TSB Group executive share plan 2005***

A further share plan has been established in connection with the recruitment of Ms Dial as an executive director.

The Lloyds TSB Group executive share plan 2005 was adopted in May 2005, specifically to facilitate the recruitment of Ms Dial. Ms Dial is the only participant in the plan and she became eligible to participate in it when she joined Lloyds TSB Group on 1 June 2005. On that same date, an option was granted to her under the plan to acquire 242,825 ordinary shares in Lloyds TSB Group plc (with a value of £1,100,000 at the date of grant) for a total exercise price of £1. No further options may be granted to her under the plan.

The option is designed to encourage Ms Dial to remain with Lloyds TSB Group plc. Accordingly, the option, which is not subject to any performance conditions, will normally become exercisable only if Ms Dial remains as an employee, and has not given notice of resignation, on 31 May 2008. The option will also be exercisable if Ms Dial ceases to be an employee before that date in certain circumstances described in her service agreement, in which case the options will be exercisable for six months and then lapse. These circumstances include her being entitled to terminate her service agreement without notice by reason of the employer's conduct or being removed as a director or employee otherwise than in accordance with that agreement. The options may also become exercisable early on a takeover or reconstruction of Lloyds TSB Group plc, if Ms Dial's service agreement is terminated by Lloyds TSB Group plc due to sickness or injury, or if she dies (in which case her personal representatives would generally have twelve months from the date of death to exercise the option).

The option will lapse if Ms Dial ceases to be an employee, or gives notice of resignation, before the normal exercise date, except in the circumstances described above.

The number and/or nominal amount of shares may be adjusted by the board on certain variations in the share capital of Lloyds TSB Group plc.

The benefit conferred by this option is not pensionable and the option is not transferable.

No new shares will be issued to satisfy the option under this plan.

None of those who were directors at the end of the year had any other interest in the capital of Lloyds TSB Group plc or its subsidiaries.

The register of directors' interests, which is open to inspection, contains full particulars of directors' shareholdings and options to acquire shares in Lloyds TSB Group.

**Employees**

As at 31 December 2005, Lloyds TSB Group employed 66,797 people (on a full-time equivalent basis), compared with 69,985 at 31 December 2004. At 31 December 2005 64,828 employees were located in the UK, 986 in continental Europe, 664 in the Americas, and 319 in the rest of the world. At the same date, 32,984 people were employed in UK Retail Banking, 5,773 in Insurance and Investments, 18,756 in Wholesale and International Banking, and 9,284 in other functions.

Lloyds TSB Group is committed to employment policies which follow best practice, based on equal opportunities for all employees irrespective of sex, race, national origin, religion, colour, disability, sexual orientation, age or marital status.

In the UK, Lloyds TSB Group supports Opportunity Now and is represented on the board of Race for Opportunity; campaigns to improve opportunities for women and ethnic minorities in the work place. Lloyds TSB Group is a gold card member of the Employers' Forum on Disability, in support of employment of people with disabilities. This recognises the need for ensuring fair employment practices in recruitment and selection, and the retention, training and career development of disabled staff.

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Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys. There are well established procedures, including regular meetings with recognised unions, to ensure that the views of employees are taken into account in reaching decisions.

Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in Lloyds TSB Group. Further details are given in Compensation .

## Corporate governance

### *Statement on US corporate governance standards*

As a non-US company listed on the New York Stock Exchange (NYSE) Lloyds TSB Group plc is required to disclose any significant ways in which its corporate governance practices differ from those followed by domestic US companies listed on the NYSE. As Lloyds TSB Group's main listing is on the London Stock Exchange, it follows the principles contained in the combined code on corporate governance annexed to the UK Listing Authority listing rules. Lloyds TSB Group has complied with the provisions of the code, and has done so throughout the year regarding the code provisions whose requirements are of a continuing nature. Key differences are set out below.

The board, rather than a separate corporate governance committee, sets the corporate governance principles applicable to the Company and conducts an annual evaluation of the performance of the board, its committees and its individual members.

The nomination committee comprises the chairman and two independent non-executive directors, rather than being comprised entirely of independent directors, as suggested by the rules of the NYSE.

### *The board and its committees*

#### *Audit committee*

The audit committee comprises Mr Brown (chairman), Mr du Plessis, Mr Gemmell, Mrs Knight and Lord Leitch, all of whom have been determined by the board to be independent directors. The committee's terms of reference are available from the company secretary and are displayed on the Company's website [www.lloydstsb.com](http://www.lloydstsb.com).

The board of directors has determined that Mr du Plessis is an audit committee financial expert (as defined in the rules under the U.S. Securities Exchange Act). Although Mr du Plessis has been identified as an audit committee financial expert for purposes of the SEC's rules, the committee members are selected with a view to the expertise and experience of the committee as a whole, and the committee reports to the board of directors as a single entity. The designation of a person as an audit committee financial expert does not impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the audit committee and board of directors in the absence of such designation. Nor does the designation of a person as an audit committee financial expert affect the duties, obligations or liability of any other member of the audit committee or board of directors.

During the year, the audit committee received reports from, and held discussions with, management and the auditors. In discharging its duties, the committee has approved the auditors' terms of engagement, including their remuneration and, in discussion with them, has assessed their independence and objectivity (more information about which is given in note 10 to the financial statements, in relation to the procedure for approving fees for audit and non-audit work) and recommended their re-appointment at the annual general meeting. The committee also reviewed the financial statements published in the name of the board and the quality and acceptability of the related accounting policies, practices and financial reporting disclosures; the scope of the work of the Group's internal audit department, reports from that department and the adequacy of its resources; the effectiveness of the systems for internal control, risk management and compliance with financial services legislation and regulations (more information about which is given in the note about internal control on page 93); the results of the external audit and its cost effectiveness; reports from the external auditors on audit planning and their findings on accounting and internal control systems; and the committee's own role and performance. Procedures for handling complaints regarding accounting, internal accounting controls or auditing matters and for staff to raise concerns in confidence were established by the committee. The committee also had a meeting with the auditors, without executives present, and a meeting with the head of internal audit alone.

#### *Chairman's committee*

The chairman's committee, comprising the chairman, the group chief executive and the deputy group chief executive, meets to assist the chairman in preparing for board meetings.

The committee may have specific powers delegated to it by the board from time to time and following the exercising of these powers, it reports to the board.

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### *Group executive committee*

The group executive committee, comprising the group chief executive, the deputy group chief executive, the group executive directors, the chief risk director, the group human resources director and the director of group IT and operations, meets to assist the group chief executive in performing his duties. Specifically, the committee considers the development and implementation of strategy, operational plans, policies and budgets; the monitoring of operating and financial performance; the assessment and control of risk; the prioritisation and allocation of resources; and the monitoring of competitive forces in each area of operation. The committee, assisted by its sub-committees, the group business risk and group asset and liability committees, also supports the group chief executive in endeavouring to ensure the development, implementation and effectiveness of the Group's risk management framework and the clear articulation of the Group's risk policies, and in reviewing the Group's aggregate risk exposures and concentrations of risk.

The committee may have specific powers delegated to it by the board from time to time and following the exercising of these powers, it reports to the board. To comply with the Group's articles of association, only committee members who are also directors of the Company participate in the exercising of any powers delegated by the board.

### *Nomination committee*

The nomination committee, comprising Mr van den Bergh (chairman until 11 May 2006 when he will be succeeded by Sir Victor Blank), Mr Brown and Dr Julius, reviews the composition of the board, taking into account the skills, knowledge and experience of directors and considers and makes recommendations to the board on potential candidates for appointment as directors. The committee also makes recommendations to the board concerning the re-appointment of any independent non-executive director by the board at the conclusion of his or her specified term; the re-election of any director by the shareholders under the retirement provisions of the articles of association; any matters relating to the continuation in office of a director; and the appointment of any director to executive or other office, other than the positions of chairman and group chief executive, the recommendation for which would be made at a meeting of the non-executive directors.

During the year, the committee recommended the appointment of one executive director and two non-executive directors. In that regard, detailed role specifications were drawn up, external search consultants were engaged and candidates were interviewed by committee members and the other directors.

In January 2006, it was announced that Mr van den Bergh had decided to retire as chairman of the Group at the annual general meeting in May. Sir Victor Blank became deputy chairman on 1 March and, subject to shareholder approval of his election as a director at the annual general meeting, will succeed Mr van den Bergh as chairman following the AGM on 11 May 2006.

Sir Victor was selected for nomination after a thorough search in which the board was assisted by Egon Zehnder International. The process was led by the senior independent non-executive director, Mr Brown, and the nomination committee for this purpose comprised all the independent non-executive directors. Candidates were interviewed by several directors and the decision was taken by the whole board, on the recommendation of the nomination committee.

Sir Victor retired from the board of Trinity Mirror at its annual general meeting in May of this year. As recently announced by GUS plc, he will remain as chairman of GUS until the proposed separation of its businesses, announced last year, but will have no continuing role in these businesses after that.

In deciding to nominate Sir Victor as chairman, the board considered the provision of the combined code on corporate governance, issued by the Financial Reporting Council, that no individual should be appointed to a second chairmanship of a FTSE 100 company. The board concluded that Sir Victor was an outstanding candidate with exceptional skills, knowledge and experience, both as a FTSE 100 company chairman and in the financial services industry, and in consultation with him, both the Lloyds TSB Group board and the GUS board have agreed that he would be able to devote sufficient time to his roles.

Lloyds TSB Group acknowledges Sir Victor's responsibilities as chairman of two FTSE 100 companies for a transitional period but the board feels that his experience will enable him to discharge his duties fully during that time. The senior independent non-executive director, Mr Brown, also recognises the importance of his role in being available to shareholders, especially during this transitional period.

Both the Association of British Insurers and the National Association of Pension Funds were consulted, in line with the principles of the combined code.

The committee's terms of reference are available from the company secretary and are displayed on the Company's website [www.lloydstsb.com](http://www.lloydstsb.com).

### *Remuneration committee*

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Information about the remuneration committee's membership and work is given in the directors' remuneration report on pages 80 to 91 and its terms of reference are available from the company secretary and are displayed on the Company's website [www.lloydstsb.com](http://www.lloydstsb.com).

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### *Risk oversight committee*

The risk oversight committee comprises Mr van den Bergh (chairman until 11 May 2006 when he will be succeeded by Sir Victor Blank), Mr Brown and Sir Julian Horn-Smith. All non-executive directors are also invited to attend meetings if they wish. The risk oversight committee's duties include overseeing the development, implementation and maintenance of the Group's overall risk governance framework, risk appetite, risk strategy and policies, to ensure they are in line with emerging regulatory, corporate governance and industry best practice. The committee also oversees the Group's risk exposures; facilitates the involvement of non-executive directors in risk issues and aids their understanding of these issues; oversees adherence to Group risk policies and standards and considers any material amendments to them; and reviews the work of the Group Risk division. The risk oversight committee reports to the board on its deliberations after each meeting.

### *Attendance at meetings*

The attendance of directors at board meetings and at meetings of the audit, nomination, remuneration and risk oversight committees during 2005 was as follows:

|   | Board | Audit committee | Nomination committee | Remuneration committee | Risk oversight committee |
|---|-------|-----------------|----------------------|------------------------|--------------------------|
| <b>Number of meetings during the year</b>       | 9     | 5               | 3                    | 7                      | 5                        |
| <b>Current directors who served during 2005</b> |       |                 |                      |                        |                          |
| W C G Berndt                                    | 9     |                 |                      | 7                      |                          |
| Ewan Brown <sup>1</sup>                         | 9     | 5               | 2                    |                        | 5                        |
| J E Daniels                                     | 9     |                 |                      |                        |                          |
| T A Dial <sup>2</sup>                           | 4     |                 |                      |                        |                          |
| J P du Plessis <sup>3</sup>                     | 2     | 1               |                      |                        |                          |
| M E Fairey                                      | 9     |                 |                      |                        |                          |
| G J N Gemmell                                   | 9     | 5               |                      | 1 (co-opted)           |                          |
| Sir Julian Horn-Smith <sup>4</sup>              | 8     |                 |                      | 6                      | 3                        |
| D S Julius                                      | 9     |                 | 3                    | 6                      |                          |
| A G Kane  | 9     |                 |                      |                        |                          |
| A A Knight                                      | 9     | 5               |                      |                        |                          |
| Lord Leitch <sup>3</sup>                        | 2     | 1               |                      |                        |                          |
| G T Tate  | 9     |                 |                      |                        |                          |
| M A van den Bergh                               | 9     |                 | 3                    |                        | 4                        |
| H A Weir  | 9     |                 |                      |                        |                          |
| <b>Former directors who served during 2005</b>  |       |                 |                      |                        |                          |
| C S Gibson-Smith <sup>5</sup>                   | 3     |                 | 2                    | 1                      |                          |
| D P Pritchard <sup>5</sup>                      | 4     |                 |                      |                        | 2                        |

<sup>1</sup> Appointed to the nomination committee from 3 March 2005

<sup>2</sup> Appointed to the board from 1 June 2005

<sup>3</sup> Appointed to the board and audit committee from 1 October 2005

<sup>4</sup> Appointed to the risk oversight committee from 3 March 2005

<sup>5</sup> Left the board on 5 May 2005

### ***Internal control***

The board of directors is responsible for the establishment and review of the Lloyds TSB Group's system of internal control, which is designed to ensure effective and efficient operations, quality of internal and external reporting, internal control, and compliance with laws and regulations. It should be noted, however, that such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. In establishing and reviewing the system of internal control the directors have regard to the nature and extent of relevant risks, the likelihood of a loss being incurred and the costs of control. It follows, therefore, that the system of internal control can only provide reasonable but not absolute

assurance against the risk of material loss.



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The directors and senior management are committed to maintaining a control-conscious culture across all areas of operation. This is communicated to all employees by way of published policies and procedures and regular management briefings. A requirement to comply with internal control and risk policies is a key component of individual staff objectives expressed in the balanced scorecard. Key business risks are identified, and these are controlled by means of procedures such as physical controls, credit, trading and other authorisation limits and segregation of duties. In addition, there is an annual control self-assessment exercise whereby the key businesses and head office functions review specific controls and attest to the accuracy of their assessments. The assessment covers all Enterprise Wide Risk Management ( EWRM ) categories and is in accordance with the principles of the Combined Code. As in previous years, this exercise was completed for the year ended 31 December 2005. All returns have been satisfactorily completed and appropriately certified.

The effectiveness of the internal control system is reviewed regularly by the board and the audit committee, which also receives reports of reviews undertaken around the Lloyds TSB Group by its risk management function, including Group Compliance, and Group Audit. The audit committee receives reports from the Company s auditors, PricewaterhouseCoopers LLP, (which include details of significant internal control matters that they have identified) and has a discussion with the auditors at least once a year without executives present, to ensure that there are no unresolved issues of concern.

### **Disclosure controls**

As of 31 December 2005, the Lloyds TSB Group, under the supervision and with the participation of the Lloyds TSB Group s management, including the group chief executive and the group finance director, performed an evaluation of the effectiveness of the Lloyds TSB Group s disclosure controls and procedures. Based on this evaluation, the group chief executive and group finance director concluded that the Lloyds TSB Group s disclosure controls and procedures are effective for gathering, analysing and disclosing the information the Lloyds TSB Group is required to disclose in the reports it files under the Securities Exchange Act of 1934, within the time periods specified in the SEC s rules and forms. The Lloyds TSB Group s management necessarily applied its judgement in assessing the costs and benefits of such controls and procedures, which by their nature can provide only reasonable assurance regarding management s control objectives.

There has been no change in the Lloyds TSB Group s internal control over financial reporting that occurred during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, the Lloyds TSB Group s internal control over financial reporting.

**MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS****Major shareholders**

According to the register maintained by Lloyds TSB Group plc under section 211 of the Companies Act 1985, as at 26 May 2006, Legal & General Investment Management Limited, Barclays PLC and The Capital Group Companies had interests of 3% (166,941,214 shares), 3.30% (184,558,340 shares) and 4.857% (272,152,525 shares), respectively, of the nominal value of the issued share capital of Lloyds TSB Group plc. Lloyds TSB Group plc does not know of any other shareholder owning beneficially, directly or indirectly, three per cent or more of the shares of Lloyds TSB Group plc, or of any shareholder having more than three per cent of the voting rights.

At 31 December 2005, those who were directors of Lloyds TSB Group plc on that day beneficially owned the following ordinary shares, not including options:

| <b>Title of class</b>                        | <b>Identity of person or group</b> | <b>Amount owned</b> | <b>Per cent of class</b> |
|--|------------------------------------|---------------------|--------------------------|
| Ordinary shares, nominal value 25 pence each | Directors (15 persons)             | 658,940             | 0.01                     |

In addition, those directors held, as at 31 December 2005, options to acquire 9,478,788 shares, all of which were granted pursuant to the executive share option schemes, sharesave share option schemes and share retention plan and conditional awards of 512,364 performance shares under the Lloyds TSB Performance Share Plan.

All shareholders within a class of the Company's shares have the same voting rights. Lloyds TSB Group plc is not owned or controlled directly or indirectly by another corporation or by any government and Lloyds TSB Group plc is unaware of any arrangements which might result in a change in control.

**Related party transactions**

Lloyds TSB Group, as at 31 December 2005, had related party transactions with 14 key management personnel. See note 49 to the Consolidated Financial Statements. The transactions in question were made in the ordinary course of business, were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons, and did not involve more than the normal risk of collectability or present other unfavourable features.

## REGULATION

### **Regulatory Requirements for UK Financial Services Institutions**

The cornerstone of the regulatory regime in the UK is the Financial Services and Markets Act 2000 ( FSMA ) which came into force on 1 December 2001 (a date known as N2) and replaced much of the previous legislation under which banks, insurance companies and investment businesses had been authorised and supervised. In accordance with the provisions of the FSMA on 30 November 2001, the Financial Services Authority ( FSA ) completed the process of assuming responsibility for the regulation and oversight of a wide range of financial services activities in the UK. Most recently these responsibilities have extended to include the regulation of mortgage lending, sales and administration (October 2004) and general insurance sales and administration (January 2005).

The FSA is responsible for the authorisation and supervision of institutions that provide regulated financial products and services as defined in the FSMA. As part of the authorisation process, the FSA reviews applicants to ensure that they satisfy the necessary criteria including honesty, competence and financial soundness, to engage in regulated activity. The majority of Lloyds TSB Group's regulated financial institutions became authorised by the FSA through being grandfathered as having been authorised under previous legislation to carry on financial services business. Following the new regulations that were introduced for mortgage and general insurance business, additional entities were authorised by FSA.

### ***Regulatory Approach of the FSA***

The FSA's regulatory approach aims to focus and reinforce the responsibility of senior management of a financial institution to ensure that it takes reasonable care to organise and control its affairs responsibly and effectively and that it develops and maintains adequate risk management systems. The FSA Handbook of Rules and Guidance (the Handbook) sets out eleven Principles for Businesses and the rules to which financial institutions are required to adhere.

A risk-based approach for the supervision of all financial institutions is adopted by the FSA and the starting point for the FSA's supervision is based on a systematic analysis of that institution's risk profile. Having determined the level of inherent risk, a minimum capital adequacy requirement is established, which the institution is required to meet at all times.

The FSA carries out its supervision of UK financial institutions through the collection of information from a series of prudential returns covering sterling and non-sterling operations, on-site reviews (through its ARROW reviews and through industry-wide Theme Reviews), desk-based reviews, meetings with senior management and reports obtained from skilled persons.

Regular reports required by the FSA include operating statements and returns covering (amongst other things) capital adequacy, liquidity, large single exposures and large exposures to related borrowers, lendings by industry sector and geographical area, maturity analyses and foreign exchange activities. Capital adequacy returns are submitted on a periodic basis for all the authorised institutions within the Lloyds TSB Group. Returns are also submitted on a consolidated basis for the Lloyds TSB Group as a whole.

The Handbook sets out rules and guidance across a range of issues with which financial institutions are required to comply. These include, inter alia:

- Authorisation requirements standards that need to be met in order to be authorised and continue to be met on an ongoing basis.
- Prudential rules relating to capital adequacy.
- Systems and Controls requirements that are appropriate to the volume and complexity of activity undertaken.
- Conduct of Business rules that set out the requirements for aspects such as advising and selling, product disclosure, financial promotions (including compliance with the clear, fair and not misleading requirements), responsible lending and default.
- Training and Competence (T&C) rules setting standards that apply to firms providing advice to retail customers.
- Code of Market Conduct rules with a view to preventing market abuse.

A key theme running through most of FSA's rules and regulations is the concept of Treating Customers Fairly. The Lloyds TSB Group has developed its own work on this issue and has embedded this concept in its activity, operations and culture.

### ***Financial Services Guarantee Schemes in the UK***

Under the FSMA a compulsory single, industry wide, investor's compensation scheme, the Financial Services Compensation Scheme has been set up. All authorised institutions are required to be members of the Financial Services Compensation Scheme and are subject to a levy in proportion to their deposit base or volume of business undertaken. The

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Scheme applies to business undertaken by an FSA authorised institution or by the UK branch of a European Economic Area firm carrying on home state regulated activity .

FSMA allows for the establishment of different funds for different kinds of business and for different maximum amounts of claim:

Bank depositors (who are eligible claimants) in the UK are provided with protection for their deposits with authorised institutions. Depositors with an institution which has been declared insolvent are entitled to receive 100 per cent of the first £2,000 and 90 per cent of the next £33,000 of their protected deposits from the Financial Services Compensation Scheme, subject to a maximum amount of £31,700, including both principal and accrued interest.

Investors can obtain a maximum award for compensation, if they have a claim against a firm which subsequently could not pay, of £48,000 (100 per cent of the first £30,000 and 90 per cent of the next £20,000).

Long-term insurance contracts compensation is limited to 100 per cent of the first £2,000 plus 90 per cent of the remainder of the value of the contract with no maximum.

### ***Authorised firms within the Lloyds TSB Group***

There are currently 26 authorised institutions within the Lloyds TSB Group. These are regulated by the FSA on both an individual and a consolidated basis.

There are six UK authorised banks: Lloyds TSB Bank plc, Lloyds TSB Scotland plc, Cheltenham & Gloucester plc, Lloyds TSB Private Banking Limited, Scottish Widows Bank plc and AMC Bank Limited.

The investment firms authorised within the Group are: Lloyds TSB Stockbrokers Limited, Scottish Widows Investment Partnership Limited, Lloyds TSB Development Capital Limited, Lloyds TSB Venture Managers Limited, Lloyds TSB Financial Consultants Limited, Lloyds TSB Independent Financial Advisers Limited, SWIP Fund Management Limited, Scottish Widows Unit Trust Managers Limited, Scottish Widows Fund Management Limited and Lloyds TSB Investments Limited.

The regulated entities conducting insurance, life and pensions business are: Black Horse Limited, Lloyds TSB Bank Insurance Brokers Limited, Lloyds TSB Insurance Services Limited, Lloyds TSB General Insurance Limited, Scottish Widows Annuities Limited, Pensions Management (SWF) Limited, Scottish Widows Unit Funds Limited, Scottish Widows plc, Abbey Life Assurance Company Limited and Lloyds TSB Life Assurance Company Limited.

### ***Basel II***

Basel II will be implemented throughout the EU through the Capital Requirements Directive. The Capital Requirements Directive will come into force for all European banks at the start of 2007, although the final rules to be applied in the UK will only be published in 2006. The rules have been, and will continue to be, subject to further consultation, and Lloyds TSB Group has been playing a full part with the regulatory authorities in attempting to shape them. The Group plans to adopt an Internal Ratings Based approach to credit risk and an Advanced Measurement Approach to operational risk. Accordingly, a considerable investment is being made in order to meet the standards required for these more advanced approaches. As well as meeting the compliance imperative, benefits to the Group will accrue through further enhancement of our risk management and capital allocation capabilities.

### **Other relevant legislation and regulation**

#### ***Financial Ombudsman Service ( FOS )***

The FOS was established at N2 pursuant to the FSMA to provide customers with a free and independent service designed to resolve disputes where the customer is not satisfied with the response received from the regulated firm. The FOS resolves disputes that cover most financial products and services provided in (or from) the UK, from insurance and pension plans to bank accounts and investments, for eligible complainants, private individuals and small businesses, charities or trusts. Although the FOS takes account of relevant regulation and legislation, their guiding principle is to resolve cases on the basis of what is fair and reasonable; in this regard, the FOS is not bound by law or even its own precedent. The decisions made by the FOS are binding on firms.

#### ***Banking Code Standards Board***

The Banking Code Standards Board monitors compliance with the Banking Code and the Business Banking Code. These Codes are voluntary codes agreed by UK banks and building societies that initially came effective in 1992, with several subsequent revisions, and which have been

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adopted by Lloyds TSB Group. The Banking Code and Business Banking Code define the responsibilities of the banks and building societies to their personal customers and smaller business customers respectively in connection with the operation of their UK accounts and sets out minimum standards of service that these customers can expect from institutions which subscribe to the Code.

### *Office of Fair Trading ( OFT )*

The OFT is responsible for regulating implementation of the Consumer Credit Act 1974 which regulates both brokerage and lending activities in the provision of personal secured and unsecured lending. The OFT is also responsible for regulating issues such as credit card default fees, payment protection insurance (in conjunction with the FSA), and

payment services.

***Information Commissioner's Office***

This office is responsible for overseeing implementation of the Data Protection Act 1998. This Act regulates, among other things, the retention and use of data relating to individual customers.

***European Union ( EU ) Impact for UK Financial Services Regulation***

Work continues on the Financial Services Action Plan which is intended to create a single market for financial services across the EU. The Lloyds TSB Group will continue to monitor the progress of these initiatives, provide specialist input on their drafting and assess the likely impact on its business.

EU directives, which are required to be implemented in EU member states through national legislation, have a strong influence over the framework for supervision and regulation of financial services in the UK. The directives aim to harmonise financial services regulation and supervision throughout the EU by setting minimum standards in key areas such as capital adequacy, access to financial markets, consumer protection and compensation schemes.

Financial institutions, such as those in the Lloyds TSB Group, are primarily regulated in their home state by a local regulator but the EU directives prescribe minimum criteria for the authorisation of such institutions and the prudential supervision applicable to them. Different directives require member states to give mutual recognition to each other's standards of regulation through the operation of a passport concept. This passport gives a financial institution which has been authorised in its home state the freedom to establish branches in, and to provide cross-border services into, other member states without the need for additional local authorisation.

Key directives currently being implemented are:

Capital Requirements Directive this comes into effect at the beginning of 2007 and will implement Basel II across the EU for banks and investment firms. The final rules in the UK will only be published in 2006 and they are likely to result in comprehensive changes to the capital adequacy regulations applicable to Lloyds TSB Group. The Lloyds TSB Group has been playing a full part with the regulatory authorities in attempting to shape them. The proposals for the new framework cover three main areas:

Minimum capital requirements and methodologies for allocation of regulatory capital for credit and other risks including operational risk.

A supervisory review process, including the setting of capital ratios by bank supervisors.

Improvement of transparency in the financial system by reliable and timely disclosure of risk information.

MiFID this is one of the key initiatives of the Financial Services Action Plan and will come into effect in November 2007. It will replace the Investment Services Directive that was introduced in 1996. The Directive:

Extends the coverage of the current regime for both firms and products;

Introduces more extensive requirements, in particular in relation to conduct of business (both business operations and customer interaction); and

Details additional governance requirements, such as organisation of risk functions, outsourcing and conflicts of interest management.

Third Money Laundering Directive this comes into effect at the end of 2007 and is designed to strengthen the fight against money laundering and terrorist financing. It will provide a common EU basis for implementing the revised FATF Recommendations (issued in June 2003) and replace the 1<sup>st</sup> and 2<sup>nd</sup> Money Laundering Directives. Changes arising through this Directive will be incorporated into the UK's Joint Money Laundering Steering Group ( JMLSG ) Guidance Notes. In the UK the JMLSG has also recently reinforced a risk-based approach to anti-money laundering.

***Rest of the world***

The Lloyds TSB Group operates in many countries around the world. The Group's overseas branches and subsidiaries are subject to reporting and reserve requirements and controls imposed by the relevant central banks and regulatory authorities.



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LISTING INFORMATION

The information in this section has been extracted from publicly available documents from various sources, including officially prepared materials from the London Stock Exchange, and has not been prepared or independently verified by the Lloyds TSB Group.

The ordinary shares of Lloyds TSB Group plc are listed and traded on the London Stock Exchange under the symbol LLOY.L. The prices for shares as quoted in the official list of the London Stock Exchange are in pounds sterling. The following table shows the reported high and low closing prices for the ordinary shares on the London Stock Exchange. This information has been extracted from publicly available documents from various sources, including officially prepared materials from the London Stock Exchange, and has not been prepared or independently verified by the Lloyds TSB Group.

|                   | Price per share (in pence)<br>High | Price per share (in pence)<br>Low |
|-------------------|------------------------------------|-----------------------------------|
| Annual prices:    |                                    |                                   |
| 2005              | 509.00                             | 439.50                            |
| 2004              | 476.25                             | 391.75                            |
| 2003              | 483.00                             | 295.75                            |
| 2002              | 817.00                             | 427.50                            |
| 2001              | 772.00                             | 590.00                            |
| 2000              | 774.50                             | 517.00                            |
| 1999              | 1,060.00                           | 725.00                            |
| 1998              | 1,075.00                           | 575.50                            |
| Quarterly prices: |                                    |                                   |
| 2006              |                                    |                                   |
| First quarter     | 573.50                             | 489.75                            |
| 2005              |                                    |                                   |
| Fourth quarter    | 489.50                             | 439.50                            |
| Third quarter     | 495.00                             | 454.00                            |
| Second quarter    | 482.50                             | 446.50                            |
| First quarter     | 509.00                             | 463.50                            |
| 2004              |                                    |                                   |
| Fourth quarter    | 473.25                             | 415.00                            |
| Third quarter     | 436.00                             | 391.75                            |
| Second quarter    | 441.50                             | 411.00                            |
| First quarter     | 476.25                             | 405.00                            |
| Monthly prices:   |                                    |                                   |
| April 2006        | 552.00                             | 522.00                            |
| March 2006        | 573.50                             | 521.75                            |
| February 2006     | 566.50                             | 521.00                            |
| January 2006      | 516.50                             | 489.75                            |
| December 2005     | 489.50                             | 471.25                            |
| November 2005     | 481.50                             | 463.25                            |

On 26 May 2006, the closing price of shares on the London Stock Exchange was 510.50 pence, equivalent to \$9.48 per share translated at the Noon Buying Rate of \$1.857 per £1.00 on 26 May 2006.

Lloyds TSB Group plc's American Depositary Receipts ( ADRs ) have been traded on the over-the-counter market in the US under the symbol LLDTY since March 2000. Since 27 November 2001 Lloyds TSB Group plc American Depositary Shares ( ADSs ) have been listed on The New York Stock Exchange under the symbol LYG. The prices for Lloyds TSB Group plc's ADRs, as quoted below, are in US dollars. Each ADS represents four ordinary shares.

The following table shows the reported high and low closing prices for the ADRs in the over-the-counter market in the US.

| Price per ADR (in US dollars)<br>High | Price per ADR (in US dollars)<br>Low |
|---------------------------------------|--------------------------------------|
|---------------------------------------|--------------------------------------|



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|                                      |       |       |
|--------------------------------------|-------|-------|
| Annual prices:                       |       |       |
| 2001 (to 26 November 2001)           | 46.00 | 34.75 |
| 2000                                 | 45.27 | 33.50 |
| Quarterly prices:                    |       |       |
| 2001                                 |       |       |
| Fourth quarter (to 26 November 2001) | 43.88 | 38.25 |
| Third quarter                        | 44.00 | 35.50 |
| Second quarter                       | 43.94 | 38.94 |
| First quarter                        | 46.00 | 34.75 |

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The following table shows the reported high and low closing prices for ADSs on the New York Stock Exchange.

|                              | Price per ADS (in US<br>dollars)<br>High | Price per ADS (in US<br>dollars)<br>Low |
|------------------------------|--|---|
| <b>Annual prices:</b>        |  |   |
| 2005                         | 39.06                                    | 31.12                                   |
| 2004                         | 36.88                                    | 29.47                                   |
| 2003                         | 32.55                                    | 19.65                                   |
| 2002                         | 48.55                                    | 27.85                                   |
| 2001 (from 27 November 2001) | 44.99                                    | 41.30                                   |
| <b>Quarterly prices:</b>     |  |   |
| 2006                         |  |   |
| First quarter                | 40.32                                    | 34.72                                   |
| 2005                         |  |   |
| Fourth quarter               | 34.46                                    | 31.12                                   |
| Third quarter                | 36.20                                    | 32.82                                   |
| Second quarter               | 36.50                                    | 33.16                                   |
| First quarter                | 39.06                                    | 35.12                                   |
| 2004                         |  |   |
| Fourth quarter               | 36.88                                    | 31.35                                   |
| Third quarter                | 31.61                                    | 29.47                                   |
| Second quarter               | 32.90                                    | 29.59                                   |
| First quarter                | 36.36                                    | 30.15                                   |
| <b>Monthly prices:</b>       |  |   |
| April 2006                   | 39.05                                    | 36.93                                   |
| March 2006                   | 40.32                                    | 36.70                                   |
| February 2006                | 39.82                                    | 36.70                                   |
| January 2006                 | 37.00                                    | 34.72                                   |
| December 2005                | 34.46                                    | 33.00                                   |
| November 2005                | 33.42                                    | 32.49                                   |

On 26 May 2006, the closing price of ADSs on the New York Stock Exchange was \$38.24.

**DIVIDENDS**

Lloyds TSB Group plc has paid an interim and final dividend each year since the merger of TSB Group plc and Lloyds Bank Plc in 1995. Dividends are typically paid in May and October and the record date for the purpose of determining the shareholders who will be entitled to a dividend is established a number of weeks before the dividend payment date. TSB Group plc, which was re-named Lloyds TSB Group plc after the merger, has paid an interim and final dividend every year since its flotation on the London Stock Exchange in September 1986, with the exception of 1986 when no final dividend was paid. Lloyds TSB Bank has paid a dividend every year since its incorporation as Lloyds Banking Company Limited in 1865.

Lloyds TSB Group plc's ability to pay dividends is restricted under UK company law. Dividends may only be paid if distributable profits are available for that purpose. In the case of a public limited company, a dividend may only be paid if the amount of net assets is not less than the aggregate of the called-up share capital and undistributable reserves and if the payment of the dividend will not reduce the amount of the net assets to less than that aggregate. In addition, a company cannot pay a dividend if any of its UK insurance subsidiaries is insolvent on a regulatory valuation basis or, in the case of regulated entities, if the payment of a dividend results in regulatory capital requirements not being met. Similar restrictions exist over the ability of Lloyds TSB Group plc's subsidiary companies to pay dividends to their immediate parent companies. Furthermore, in the case of Lloyds TSB Group plc, dividends may only be paid if sufficient distributable profits are available for distributions due in the financial year on certain preferred securities. The board has the discretion to decide whether to pay a dividend and the amount of any dividend. In making this decision, the board is mindful of the level of dividend cover and, consequently, profit growth may not necessarily result in increases in the dividend. The board recognises the importance attached by shareholders to the Lloyds TSB Group's dividend. In the case of American Depositary Shares (ADSs), dividends are paid through The Bank of New York which acts as paying and transfer agent.

The table below sets out the interim and final dividends which were declared in respect of the ordinary shares for fiscal years 2001 through 2005. The sterling amounts have been converted into US dollars at the Noon Buying Rate in effect on each payment date.

|             | Interim dividend<br>per share<br>£ | Interim dividend<br>per share<br>\$ | Final dividend<br>per share<br>£ | Final dividend<br>per share<br>\$ |
|-------------|------------------------------------|-------------------------------------|----------------------------------|-----------------------------------|
| 2001        | 0.102                              | 0.149                               | 0.235                            | 0.344                             |
| 2002        | 0.107                              | 0.167                               | 0.235                            | 0.374                             |
| 2003        | 0.107                              | 0.178                               | 0.235                            | 0.419                             |
| 2004        | 0.107                              | 0.190                               | 0.235                            | 0.447                             |
| <b>2005</b> | <b>0.107</b>                       | <b>0.189</b>                        | <b>0.235</b>                     | <b>0.433</b>                      |

There are no UK governmental laws, decrees or regulations that affect the remittance of dividends or other shareholder payments to non-residents of the UK who hold shares of Lloyds TSB Group plc.

**MEMORANDUM AND ARTICLES OF ASSOCIATION OF LLOYDS TSB GROUP PLC**

A summary of the material provisions of Lloyds TSB Group plc's memorandum and articles of association is set out below. This has been updated from the summary that was incorporated into Lloyds TSB Group plc's registration statement filed with the SEC on 25 September 2001 and reflects changes to the memorandum and articles of association approved by the shareholders of Lloyds TSB Group plc at its annual general meeting in May 2006.

Lloyds TSB Group plc is incorporated in Scotland under the UK Companies Act 1985 with registered number SC95000.

***Objects of Lloyds TSB Group plc***

Lloyds TSB Group plc's objects are:

Clause 4(1)(a) of the memorandum of association of Lloyds TSB Group plc (the Memorandum): to take over and hold all or such part of the property and rights, and to assume and undertake all or such part of the liabilities and obligations, of the Trustee Savings Banks Central Board (the Central Board), Trustee Savings Banks (Holdings) Limited (TSB Holdings) and the trustee savings banks (meaning the banks defined as the existing banks in the Trustee Savings Banks Act 1985, the TSBA) as shall be transferred to and vested in Lloyds TSB Group plc under the TSBA; and

Clause 4(1)(b) of the Memorandum: to act as the holding company for:

(i) the companies formed or to be formed with objects including that of assuming and conducting, after the vesting day, as the same is defined in the TSBA, the respective business of the trustee savings banks and eligible to succeed them respectively within the meaning of Section 1(2) of the TSBA; and (ii) the companies which, immediately before the said vesting day, are subsidiaries of the trustee savings banks, the Central Board or TSB Holdings; and

Clause 4(7) of the Memorandum: to carry on the business of banking in all its aspects, including but not limited to all businesses of a financial or monetary nature and any business which now is or at any time during the existence of Lloyds TSB Group plc may be usually or commonly carried on as part of or in connection with, or which may conduce to or be calculated to facilitate or render profitable or more profitable the transaction of, the business of banking or of dealing in money or securities or the provision of financial services of any kind, in any part of the world.

***Voting rights***

For the purposes of determining which persons are entitled to attend or vote at a meeting and how many votes such person may cast, Lloyds TSB Group plc may specify in the notice of the meeting a time, not more than 48 hours before the time fixed for the meeting, by which a person must be entered on the register in order to have the right to attend or vote at the meeting. Every holder of ordinary shares who is entitled to be and is present in person (including any corporation by its duly authorised representative) at a general meeting of Lloyds TSB Group plc and is entitled to vote will have one vote on a show of hands and, on a poll, if present in person or by proxy, will have one vote for every such share held by him, save that a member will not be entitled to exercise the right to vote carried by such shares if he or any person appearing to be interested in the shares held by him has been duly served with a notice under section 212 of the UK Companies Act 1985 (requiring disclosure of interests in shares) and is in default in supplying Lloyds TSB Group plc with information required by such notice. The limited voting shares confer the right to receive notice of and to attend and speak at all general meetings of Lloyds TSB Group plc, but do not confer a right to vote unless the business of the meeting includes the consideration of a resolution:

to approve an acquisition or disposal by Lloyds TSB Group plc or any of its subsidiaries in circumstances in which the approval of shareholders in general meeting is either required by virtue of securities of Lloyds TSB Group plc being listed on a recognised exchange, or is sought by the directors, due to the significance of the transaction, or

for the winding-up of Lloyds TSB Group plc, or

to vary the rights of the limited voting shares.

In any such case, the holder may vote the limited voting shares only in respect of such resolution and will have the same rights in regard to the number and exercise of votes as a holder of ordinary shares but in the case of a variation in the rights of limited voting shares, shall also have the protection of a requirement for approval of the variation by a separate class meeting of the holders of limited voting shares.

Preference shares confer such rights as may be determined by the directors on allotment, but unless the directors otherwise determine, fully paid preference shares confer identical rights as to voting, capital dividends and otherwise, notwithstanding that they are denominated in different currencies and shall be treated as if they are one single class of shares.

There are no limitations imposed by UK law or the memorandum and articles of association of Lloyds TSB Group plc restricting the rights of non-residents of the UK or non-citizens of the UK to hold or vote shares of Lloyds TSB Group plc.

***General meetings***

The directors may make arrangements to control the level of attendance at any place specified for the holding of a general meeting and, in any such case, shall direct that the meeting be held at a specified place, where the chairman of the meeting shall preside, and make arrangements for simultaneous attendance and participation by members and proxies at other locations. The chairman of a general meeting has express authority to adjourn the meeting if, in his opinion, it appears impracticable to hold or continue the meeting because of crowding or unruly conduct or because an adjournment is otherwise necessary for the proper conduct of the meeting. Annual general meetings of Lloyds TSB Group plc are to be held in Edinburgh or such other place in Scotland as the directors shall appoint.

***Dividends and other distributions and return of capital***

The shareholders in general meeting may by ordinary resolution declare dividends to be paid to members of Lloyds TSB Group plc, but no dividends shall be declared in excess of the amount recommended by the directors. The directors may pay fixed dividends and may also from time to time pay dividends, interim or otherwise. Except in so far as the rights attaching to any shares otherwise provide, all dividends shall be apportioned and paid pro rata according to the amounts paid up thereon. Subject to the rights attaching to any shares, any dividend or other monies payable in respect of a share may be paid in such currency or currencies as the directors may determine.

The opportunity to elect to receive new shares instead of any cash dividend recommended by the directors, may be offered to shareholders provided that the directors shall have obtained in advance the shareholders' approval to do so as required by the articles of association.

The limited voting shares do not confer a right to participate in any distribution of profits by way of dividend. For any other distributions, the limited voting shares shall be deemed to confer rights and interests in the profits equally with the holders of shares according to the amounts paid up on such limited voting shares and shares respectively otherwise than in advance of calls.

On any distribution by way of capitalisation, the amount to be distributed will be appropriated amongst the holders of shares and limited voting shares in proportion to their holdings of shares and limited voting shares (pro rata to the amount paid up thereon). If the amount to be distributed is applied in paying up in full unissued shares and limited voting shares of Lloyds TSB Group plc, a shareholder will be entitled to receive bonus shares of the same class as the shares giving rise to his entitlement to participate in the capitalisation.



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Any dividend unclaimed after a period of 12 years from the date of declaration will be forfeited and revert to Lloyds TSB Group plc. No dividends or other monies payable on or in respect of a share shall bear interest against Lloyds TSB Group plc.

On a return of capital, whether in a winding-up or otherwise, the shares and the Limited Voting Shares will rank equally in all respects.

### *Conversion of limited voting shares*

Each limited voting share will be converted into an ordinary share:

on the day following the last date on which an amount could become due and payable to a holder of limited voting shares under a deed of covenant in favour of the Lloyds TSB Foundations. A deed of covenant is a legal document which records the obligation of one person to pay a specified sum to another for a specified number of years; or

if an offer is made to shareholders (or to all such shareholders other than the offeror and/or any body corporate controlled by the offeror and/or any persons acting in concert with the offeror) to acquire the whole or any part of the issued ordinary share capital of Lloyds TSB Group plc and the right to cast more than 50 per cent of the votes which may ordinarily be cast on a poll at a general meeting of Lloyds TSB Group plc becomes or is certain to become vested in the offeror and/or any bodies corporate controlled by the offeror and/or any persons acting in concert with the offeror. The publication of a scheme of arrangement under the statutes providing for the acquisition by any person of the whole or part of the ordinary share capital of Lloyds TSB Group plc shall be deemed to be the making of an offer for this purpose.

The shares resulting from conversion will carry the right to receive all dividends and other distributions declared, made or paid on the ordinary share capital of Lloyds TSB Group plc by reference to a record date on or after the date of conversion and will rank equally in all other respects and form one class with the ordinary share capital of Lloyds TSB Group plc then in issue and fully paid.

Holders of limited voting shares will be entitled to participate in any offer made by way of rights to holders of shares as if the limited voting shares had been converted at the relevant record date.

### *Variation of rights and alteration of capital*

Subject to the provisions of the UK Companies Act 1985, the CREST regulations and every other statute for the time being in force or any judgement or order of any court of competent jurisdiction concerning companies and affecting Lloyds TSB Group plc (the statutes), the rights attached to any class of shares for the time being in issue may (subject to their terms of issue) be varied, modified or abrogated with the consent in writing of the holders of not less than three fourths in nominal value of the issued shares of that class or with the sanction of an extraordinary resolution passed at a separate meeting of the holders of shares of that class. At any such separate meeting, the provisions of the articles of association relating to general meetings will apply, but the necessary quorum at any such meeting will be two persons holding or representing by proxy at least one-third in nominal value of the issued shares of that class (except at an adjourned meeting, at which the quorum shall be any holder of shares of the class, present in person or by proxy) and any such person may demand a poll.

Lloyds TSB Group plc may, by ordinary resolution, increase its share capital, consolidate and divide all or any of its shares into shares of larger amount, sub-divide all or any of its shares into shares of smaller amount and cancel any shares not taken or agreed to be taken by any person.

However, for so long as the limited voting shares have not been converted (as described above);

Lloyds TSB Group plc is prohibited from consolidating or subdividing any of the shares without consolidating or subdividing the limited voting shares in like manner and to a like extent; and

Lloyds TSB Group plc will not create any new class of equity share capital, other than in connection with or pursuant to an employees share scheme approved by Lloyds TSB Group plc in general meeting, provided that the creation of equity share capital which carries (as compared with the existing Lloyds TSB Group plc shares) only restricted voting or no voting rights and no greater rights as regards dividends or capital shall not be deemed to be the creation of a new class of equity share capital.

Subject to the provisions of the UK Companies Act 1985, Lloyds TSB Group plc may, by special resolution, reduce its share capital, any capital redemption reserve, share premium account or other undistributable reserve in any way.

### *Transfer of shares*

All transfers of shares which are in certificated form may be effected by transfer in writing in any usual or common form or in any other form acceptable to the directors and must be executed by or on behalf of the transferor and, if the shares thereby transferred are not fully paid, by or

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on behalf of the transferee. The transferor will be deemed to remain the holder of the shares transferred until the name of the transferee is entered in the register of members of Lloyds TSB Group plc in respect thereof. All transfers of shares which are in uncertificated form may be affected by means of a relevant system.

The directors may, in the case of shares in certificated form, in their absolute discretion and without assigning any reason therefore, refuse to register any transfer of a share (not being a fully paid share) provided that, where any such shares are admitted to the official list maintained by the UK Listing Authority, such discretion may not be exercised in such a way as to prevent dealings in the shares of that class from taking place on an open and proper basis. The directors may also decline to register a transfer unless either:



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the instrument of transfer complies with the requirements of the articles of association; and the transfer is in respect of only one class of shares; or

the transfer is in favour of not more than four persons as the transferee. The articles of association contain no restrictions on free transferability of fully paid shares.

The directors shall refuse to register the transfer of any share on which Lloyds TSB Group plc has a lien and shall refuse to register the transfer of any limited voting share unless the same is:

between existing holders of limited voting shares; or

under a scheme established or order made by the Charity Commissioners or by the court to a transferee having charitable objects; or

in the course of a winding-up to an institution having charitable objects which prohibit distributions of income and property to members to at least the same extent as is imposed on the transferor by its memorandum of association; or

at the direction of the crown to another charity having similar objects.

Lloyds TSB Group plc's shares are in registered form and the articles of association do not provide for bearer shares. The registration of share transfers may be suspended and the register may be closed at such times and for such periods as the directors may determine (not exceeding 30 days in any year), provided that if the shares are traded through an electronic trading system, the register may not be closed without the consent of the operator.

Subject to the statutes and the rules (as defined in the CREST regulations), the directors may determine that any class of shares may be held in uncertificated form and that title to such shares may be transferred by means of an electronic trading system or that shares of any class should cease to be so held and so transferred.

### ***Untraced members***

Lloyds TSB Group plc is empowered to sell, as the agent of a member, at the best price reasonably obtainable, any share registered in the name of a member remaining untraced for 12 years who fails to communicate with Lloyds TSB Group plc within 3 months following the publication of an advertisement of an intention to make such a disposal; provided that during the 12 year period at least three dividends have become payable and no dividend has been claimed. Lloyds TSB Group plc shall be obliged to account to the member for the proceeds of the disposal. However, any net proceeds of sale unclaimed after 12 years from the date of sale shall be forfeited and shall revert to Lloyds TSB Group plc.

### ***Forfeiture and lien***

If a member fails to pay in full any call or instalment of a call on or before the due date for payment, then, following notice by the directors requiring payment of the unpaid amount with any accrued interest and any expenses incurred, such share may be forfeited by a resolution of the directors to that effect (including all dividends declared in respect of the forfeited share and not actually paid before forfeiture). A member whose shares have been forfeited will cease to be a member in respect of the shares, but will, notwithstanding the forfeiture, remain liable to pay to Lloyds TSB Group plc all monies which at the date of forfeiture were presently payable together with interest. The directors may at their absolute discretion enforce payment without any allowance for the value of the shares at the time of forfeiture or for any consideration received on their disposal or waive payment in whole or part.

Lloyds TSB Group plc has a first and paramount lien on every share (not being a fully paid share) for all monies (whether presently payable or not) called or payable at a fixed time in respect of such share, and the directors may waive any lien which has arisen and may resolve that any share shall for some limited period be exempt from such a lien, either wholly or partially.

A forfeited share becomes the property of Lloyds TSB Group plc, and it may be sold, re-allotted, otherwise disposed of or cancelled as the directors see fit. Lloyds TSB Group plc will have a first lien on every share not being a fully paid share, for all moneys (whether payable presently or not) called or payable at a fixed date, in respect of such share. Any share on which Lloyds TSB Group plc has a lien may be sold on the terms set out in the articles of association. The proceeds of sale shall first be applied towards payment of the amount in respect of the lien insofar as it is still payable and then on surrender of the share certificate for cancellation (in the case of shares in certificated form), to the person entitled to the shares at the time of sale.

### ***Purchase of own shares***

Subject to the provisions of the statutes, Lloyds TSB Group plc may purchase any of its own shares of any class, but if there are in issue any shares which are quoted on the London Stock Exchange and which are convertible into equity share capital of Lloyds TSB Group plc of the class proposed to be purchased, then Lloyds TSB Group plc will not purchase such equity shares unless the terms of the convertible shares include

provisions permitting Lloyds TSB Group plc to purchase its own equity shares or providing for adjustment to the conversion terms upon such a purchase or the purchase has first been approved by an extraordinary resolution passed at a separate meeting of the holders of such convertible shares.

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### *Winding-up*

If Lloyds TSB Group plc is wound up, the liquidator may, with the authority of an extraordinary resolution, divide amongst the members in specie or kind the whole or any part of the assets of Lloyds TSB Group plc. The liquidator may for such purpose set such value as he deems fair upon any one or more class or classes of property and may determine how such division shall be carried out as between the members or different classes of members. The liquidator may vest any part of the assets in trustees upon such trusts for the benefit of members as the liquidator thinks fit, and the liquidation of Lloyds TSB Group plc may be closed and dissolved, but so that no contributory shall be compelled to accept any shares or other property in respect of which there is a liability.

### *Directors*

#### *General*

The business and affairs of Lloyds TSB Group plc shall be managed by the directors who may exercise all such powers of Lloyds TSB Group plc as are not by the statutes or by the articles of association required to be exercised by Lloyds TSB Group plc in general meeting, subject to the articles of association, to the provisions of the statutes and to such regulations as may be set by special resolution of Lloyds TSB Group plc, but no regulation so made by Lloyds TSB Group plc will invalidate any prior act of the directors which would have been valid if such regulation had not been made.

The directors may confer upon any director holding any executive office any of the powers exercisable by them on such terms and conditions, and with such restrictions, as they think fit. The directors may also delegate any of their powers to committees. Any such committee shall have power to sub-delegate to sub-committees or to any person any of the powers delegated to it. Any such committee or sub-committee shall consist of one or more directors only. The meetings and proceedings of any such committee or sub-committee consisting of two or more persons shall be governed, with such changes as are appropriate, by the provisions of the articles of association regulating the meetings and proceedings of the directors.

#### *Material interests*

Subject to any applicable laws, regulations or court orders in force at the time, a director, provided that he has disclosed to the other directors the nature and extent of his interests:

may be a party to, or otherwise interested in, any contract, transaction or arrangement with Lloyds TSB Group plc or in which Lloyds TSB Group plc is otherwise interested;

may be a director or other officer of, or employed by, or a party to any contract, transaction or arrangement with, or otherwise interested in, any body corporate promoted by Lloyds TSB Group plc or in which Lloyds TSB Group plc is otherwise interested;

may (or any firm of which he is a partner, employee or member may) act in a professional capacity for Lloyds TSB Group plc (other than as auditor) and be remunerated therefore; and

shall not, save as otherwise agreed by him, be accountable to Lloyds TSB Group plc for any benefit which he derives from any such contract, transaction or arrangement or from any such office or employment or from any interest in any such body corporate or for such remuneration, and no such contract, transaction or arrangement shall be liable to be avoided on the grounds of any such interest or benefit.

Except as set out in Lloyds TSB Group plc's articles of association, a director shall not vote in respect of any contract or arrangement or any other proposal in which he has any material interest otherwise than by virtue of interests in shares or debentures or other securities of Lloyds TSB Group plc. A director shall not be counted in the quorum at a meeting in relation to any resolution on which he is not entitled to vote.

A director shall be entitled to vote and be counted in the quorum in respect of any proposal concerning indemnities in favour of directors or the funding by Lloyds TSB Group plc of expenditure by a director on defending proceedings against him or applications by him for relief from liability, including any action to enable such director to avoid incurring such expenditure.

#### *Remuneration*

The ordinary remuneration of the directors is determined by ordinary resolution of Lloyds TSB Group plc and is divisible among the directors as they may agree, or, failing agreement, equally. However, any director who holds office for only part of the period in respect of which remuneration is payable shall be entitled only to rank in such division for a proportion of the remuneration relating to the period during which he has held office. Any director who holds an executive office, or who serves on any committee of the directors, or who otherwise performs services which in the opinion of the directors are outside the scope of the ordinary duties of a director, may be paid extra remuneration by way of

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salary, commission or otherwise or may receive such other benefits as the directors may determine. The directors may repay to any director all such reasonable expenses as he may incur in attending and returning from meetings of the directors or of any committee of the directors or general meetings or otherwise in connection with the business of Lloyds TSB Group plc. The directors have the power to pay and agree to pay gratuities, pensions or other retirement, superannuation, death or disability benefits to, or to any person in respect of, any director or ex-director.

The quorum necessary for the transaction of business of the directors may be fixed from time to time by the directors and unless so fixed at any other number shall be four. Questions arising at any meeting of the directors shall be determined by a majority of votes. In the case of an equality of votes, the chairman of the meeting shall have a second or casting vote.

*Borrowing powers*

Under its memorandum of association, Lloyds TSB Group plc may borrow or raise money in such manner and upon such terms and on such security as may seem to the directors to be expedient and in particular by the issue or deposit of debentures or debenture stock or other securities of any description and to secure all or any of Lloyds TSB Group plc's liabilities in respect of money borrowed, raised or owing or any other debt or obligation of or binding on Lloyds TSB Group plc in such manner as may be thought expedient and in particular by mortgage, charge or lien upon all or any part of the undertaking, property and assets, present or future, and uncalled capital of Lloyds TSB Group plc.

*Retirement*

The articles of association provide broadly that at each annual general meeting one-third (but not more than one third) of the directors should retire by rotation, subject to possible re-election. The individual directors to retire in a particular year shall be those who have been in post the longest since last being elected.

*Share qualification*

A director is not required to hold any shares of Lloyds TSB Group plc by way of qualification.

**EXCHANGE CONTROLS**

There are no UK laws, decrees or regulations that restrict Lloyds TSB Group plc's export or import of capital, including the availability of cash and cash equivalents for use by Lloyds TSB Group, or that affect the remittance of dividends or other shareholders payments to non-UK holders of Lloyds TSB Group plc shares, except as otherwise set out in Taxation .

**TAXATION**

**UK taxation**

The following discussion is intended only as a general guide to current UK tax legislation, what is understood to be current UK HM Revenue & Customs practice and the terms of the current UK/US income tax treaty (the Treaty), all of which are subject to change at any time, possibly with retroactive effect.

The Treaty for the avoidance of double taxation with respect to taxes on income entered into force following the exchange of instruments of ratification by the UK Parliament and the US Senate on 31 March 2003.

The UK HM Revenue & Customs is the UK government department responsible for assessing and collecting UK tax revenues. The discussion is intended as a general guide and only applies to persons who are the beneficial owners of their ordinary shares or ADSs. References below to a US holder are to that term as defined, and subject to the exclusions described in the introduction, below under US federal income tax considerations. It may not apply to certain shareholders or ADS holders, such as dealers in securities.

Tax can be complicated and individual circumstances may need to be considered in more detail. Any person who is in any doubt as to his tax position should consult his own professional adviser.

***Taxation of chargeable gains***

*UK residents*

A disposal (or deemed disposal) of ordinary shares or ADSs by a shareholder or holder of ADSs resident or (in the case of an individual) ordinarily resident for tax purposes in the UK may, depending on the shareholder's or ADS holder's particular circumstances, and subject to any available exemption or relief, give rise to a chargeable gain or an allowable loss for the purposes of UK taxation on chargeable gains.

*Individuals, other than US holders, temporarily non-resident in the UK*

A shareholder or ADS holder who is an individual and who has, on or after 17 March 1998, ceased to be resident and ordinarily resident for tax purposes in the UK for a period of less than five years of assessment and who disposes of ordinary shares or ADSs during that period may be liable, on return to the UK, to UK taxation on chargeable gains arising during the period of absence, subject to any available exemption, relief and/or foreign tax credit.

*US holders*

Subject to the provisions set out in the next paragraph in relation to temporary non-residents, US holders generally will not be liable for UK tax on chargeable gains unless they carry on a trade, profession or vocation in the UK through a branch or agency and the ordinary shares or ADSs are or have been used or held by or for the purposes of the branch or agency, in which case such US holder might, depending on individual circumstances, be liable to UK tax on chargeable gains on any disposition of ordinary shares or ADSs. An individual US holder who is only temporarily not resident in the UK may, under anti-avoidance legislation, still be liable for UK tax on chargeable gains realised, subject to any available exemption, relief and/or foreign tax credit.

A US holder who is an individual and who has, on or after 17 March 1998, ceased to be resident or ordinarily resident for tax purposes in the UK for a period of less than five years of assessment and who disposes of ordinary shares or ADSs during that period may be liable, on return to the UK, to UK taxation on chargeable gains arising during the period of absence, subject to any available exemption, relief and/or foreign tax credit.

*Other non-UK resident persons*

Subject to the provisions set out above under Individuals, other than US holders, temporarily non-resident in the UK, shareholders or ADS holders who are neither resident nor ordinarily resident in the UK generally will not be liable for UK tax on chargeable gains unless they carry on a trade, profession or vocation in the UK through a branch or agency and the ordinary shares or ADSs are or have been used or held by or for the purposes of the branch or agency, in which case such shareholder or ADS holder might, depending on individual circumstances, be liable to UK tax on chargeable gains on any disposition of ordinary shares or ADSs. An individual holder of ordinary shares or ADSs who is only temporarily not resident in the UK may, under anti-avoidance legislation, still be liable for UK tax on chargeable gains realised, subject to any available exemption, relief and/or foreign tax credit.

***Taxation of dividends***

*UK residents*

Lloyds TSB Group will not be required to withhold tax at source when paying a dividend on the ordinary shares or ADSs.

An individual shareholder or ADS holder who is resident in the UK for tax purposes will be entitled to a tax credit in respect of any dividend received from the Lloyds TSB Group and will be taxable on the gross dividend, which is the aggregate of the dividend received and related tax credit. The value of the tax credit will be equal to one-ninth of the dividend received (and, therefore, 10 per cent of the gross dividend). The gross dividend will be treated as an individual's marginal taxable income. The tax credit will, however, be treated as discharging the individual's liability to income tax in respect of the gross dividend, unless and except to the extent that the gross dividend falls above the

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threshold for the higher rate of income tax. A UK resident individual shareholder or ADS holder who is liable to income tax at the higher rate (currently 40 per cent) will be subject to tax at the rate applicable to dividends for such shareholders or ADS holders (currently 32.5 per cent) on the gross dividend. The tax credit will be set against but will not fully discharge such shareholders' or ADS holders' tax liability on the gross dividend and they will have to pay additional tax equal to 22.5 per cent of the gross dividend, being 25 per cent of the dividend received, to the extent that such sum, when treated as marginal income, falls above the threshold for the higher rate of income tax.

There will be no payment of the tax credit or any part of it to an individual whose liability to income tax on the dividend and the related tax credit is less than the tax credit.

UK resident shareholders or ADS holders who are not liable to UK tax on dividends, including pension funds and charities, will not be entitled to the payment of any tax credits in respect of dividends.

Subject to certain exceptions, such as for dealers in securities and for some insurance companies with overseas business, UK resident corporate shareholders or ADS holders will generally not be subject to corporation tax in respect of dividends received from Lloyds TSB Group, but will not be entitled to the payment of any tax credit with respect to the dividends.

### *US holders*

Lloyds TSB Group will not be required to withhold tax at source when paying a dividend on the ordinary shares or ADSs to a US holder.

### *Other non-UK resident persons*

Lloyds TSB Group will not be required to withhold tax at source when paying a dividend on the ordinary shares or ADSs to a holder, other than a US holder, who is not resident for tax purposes in the UK.

Holders of ordinary shares or ADSs, other than US holders, who are not resident for tax purposes in the UK and who receive a dividend from the Lloyds TSB Group will not have any further UK tax to pay in respect of the dividend, but will not normally be able to claim any additional payment in respect of the dividend from the UK HM Revenue & Customs under any applicable Double Tax Treaty.

### **Stamp duty and stamp duty reserve tax**

#### *UK residents, US holders and other non-UK resident persons*

Any conveyance or transfer on sale of ordinary shares (whether effected using the CREST settlement system or not) will be subject to UK stamp duty or stamp duty reserve tax (SDRT). The transfer on sale of ordinary shares will be liable to ad valorem UK stamp duty or SDRT, generally at the rate of 0.5 per cent of the consideration paid (rounded up to the next multiple of £5 in the case of stamp duty). Stamp duty is usually the liability of the purchaser or transferee of the ordinary shares. An unconditional agreement to transfer such ordinary shares will be liable to SDRT, generally at the rate of 0.5 per cent of the consideration paid, but such liability will be cancelled, or, if already paid, refunded, if the agreement is completed by a duly stamped transfer within six years of the agreement having become unconditional. SDRT is normally the liability of the purchaser or transferee of the ordinary shares.

Where Lloyds TSB Group issues ordinary shares or a holder of ordinary shares transfers such shares to the custodian or nominee for the depositary to facilitate the issue of ADSs to him representing the ordinary shares or to a person providing clearance services (or their nominee or agent), a liability to UK stamp duty or SDRT at the rate of 1.5 per cent (rounded up to the next multiple of £5 in the case of the stamp duty) of either the issue price or, in the case of transfer, the listed price of the ordinary shares, calculated in sterling, will arise. Where a holder of ordinary shares transfers such shares to the custodian or nominee for the depositary or clearance service this charge will generally be payable by the person receiving the ADSs or transferring the ordinary shares into the clearance service.

A liability to stamp duty at the fixed rate of £5 will arise as a result of the cancellation of any ADSs with the ordinary shares that they represent being transferred to the ADS holder.

No liability to UK stamp duty or SDRT will arise on a transfer of ADSs provided that any document that effects such transfer is not executed in the UK and that it remains at all subsequent times outside the UK. An agreement to transfer ADSs will not give rise to a liability to SDRT.

### **US federal income tax considerations**

The following summary describes material US federal income tax consequences of the acquisition, ownership and disposition of ADSs or ordinary shares to US holders (defined below), but it does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to acquire such securities. The summary applies only to US holders that hold ADSs or ordinary shares as capital assets



and does not address special classes of holders, such as:

certain financial institutions;

insurance companies;

dealers in securities or foreign currencies;

holders holding ADSs or shares as part of a hedge, straddle, conversion or other integrated transaction;

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holders whose functional currency for US federal income tax purposes is not the US dollar;

holders liable for alternative minimum tax;

holders who acquired ADSs or shares pursuant to the exercise of any employee stock option or otherwise as compensation;

partnerships or other entities classified as partnerships for US federal income tax purposes; or

a holder that owns 10 per cent or more of the voting shares of Lloyds TSB Group plc.

In addition, the summary is based in part on representations of the Depositary and assumes that each obligation provided for in or otherwise contemplated by the Deposit Agreement or any other related document will be performed in accordance with its terms. The US Treasury has expressed concerns that parties to whom ADSs are pre-released may be taking actions that are inconsistent with the claiming of foreign tax credits for US holders of ADSs. Such actions would also be inconsistent with the reduced rate of tax applicable to dividends received by certain non-corporate US holders. Accordingly, the analysis of the reduced rate of tax applicable to dividends received by certain non-corporate US holders described below could be affected by actions that may be taken by parties to whom ADSs are pre-released. The summary is based upon tax laws of the US including the Internal Revenue Code of 1986, as amended to the date hereof (the Code), administrative pronouncements, judicial decisions and final, temporary and proposed Treasury Regulations, as well as the Treaty, changes to any of which may affect the tax consequences described herein, possibly with retroactive effect. Prospective purchasers of the ADSs or ordinary shares should consult their own tax advisers as to the US, UK or other tax consequences of the purchase, ownership and disposition of such securities in their particular circumstances, including the effect of any US state or local tax laws.

As used herein, a US holder is a beneficial owner of ADSs or shares, that is, for US federal income tax purposes:

a citizen or resident of the US;

a corporation, or other entity taxable as a corporation, created or organised in or under the laws of the US or of any political subdivision thereof; or

an estate or trust the income of which is subject to US federal income taxation regardless of its source.

For US federal income tax purposes, US holders of ADSs generally will be treated as the owners of the underlying ordinary shares.

#### *Taxation of distributions*

To the extent paid out of current or accumulated earnings and profits of Lloyds TSB Group plc (as determined in accordance with US federal income tax principles), distributions made with respect to ADSs or ordinary shares (other than certain pro rata distributions of shares of Lloyds TSB Group plc or rights to subscribe for shares of Lloyds TSB Group plc) will be includable in the income of a US holder as ordinary dividend income from non-US sources. Such dividends will not be eligible for the dividends-received deduction generally allowed to corporations under the Code.

Subject to applicable limitations that may vary depending upon a holder's individual circumstances and the discussion above regarding concerns expressed by the US Treasury, dividends paid to certain non-corporate US holders in taxable years beginning before 1 January 2011 will be taxable at a maximum tax rate of 15 per cent. Non-corporate US holders should consult their own tax advisers to determine whether they are subject to any special rules that limit their ability to be taxed at this favourable rate.

The amount of the dividend will equal the US dollar value of the pounds sterling received, calculated by reference to the exchange rate in effect on the date such distribution is received by the Depositary (in the case of ADSs) or by the US holder (in the case of shares) regardless of whether the payment is converted into US dollars on the date of receipt. If the pounds sterling received as a dividend are not converted into US dollars on the date of receipt, then the US holder's tax basis in the pounds sterling received will equal such dollar amount and the US holder may realise an exchange gain or loss on the subsequent conversion into US dollars. Any gains or losses resulting from the conversion of pounds sterling into US dollars will be treated as US source ordinary income or loss.

#### *Taxation of capital gains*

Gain or loss realised by a US holder on a sale or exchange of ADSs or shares will be subject to US federal income tax as capital gain or loss in an amount equal to the difference between the US holder's tax basis in the ADSs or shares and the amount realised on the disposition. Gains or losses, if any, will generally be US source and will be long-term if the ADSs or shares were held for more than one year.

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Deposits and withdrawals of ordinary shares in exchange for ADSs will not result in taxable gain or loss for US federal income tax purposes.

### *Information reporting and backup withholding*

Dividends paid on, and the sale proceeds from, ADSs or shares that are made within the US or through certain US-related financial intermediaries generally are subject to information reporting requirements. Such dividends may also be subject to backup withholding unless the US holder:

is a corporation or comes within certain other exempt categories and, when required, demonstrates this fact, or

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provides a taxpayer identification number on a properly completed Form W-9 or a substitute form and certifies that no loss of exemption from backup withholding has occurred and that such holder is a US person. Any amount withheld under these rules will be creditable against the US holder's federal income tax liability. A US holder who does not provide a correct taxpayer identification number may be subject to certain penalties.

#### **WHERE YOU CAN FIND MORE INFORMATION**

The documents concerning us which are referred to herein may be inspected at the Securities and Exchange Commission ( SEC ). You may read and copy any document filed or furnished by us at the SEC's public reference rooms in Washington D.C., New York and Chicago, Illinois. Please call the SEC at 1-800-SEC-0330 for further information on the reference rooms. The SEC also maintains a website at [www.sec.gov](http://www.sec.gov) which contains, in electronic form, each of the reports and other information that we have filed electronically with the SEC.

#### **ENFORCEABILITY OF CIVIL LIABILITIES**

Lloyds TSB Group plc is a public limited company incorporated under the laws of Scotland. Most of Lloyds TSB Group plc's directors and executive officers and certain of the experts named herein are residents of the United Kingdom. A substantial portion of the assets of Lloyds TSB Group plc, and a substantial portion of the assets of such persons, are located outside the United States. As a result, it may not be possible for investors to effect service of process within the United States upon all such persons or to enforce against them in the United Kingdom judgements of US courts, including judgements predicated upon the civil liability provisions of the federal securities laws of the United States. Furthermore, Lloyds TSB Group plc has been advised by its English solicitors that there is doubt as to the enforceability in the United Kingdom, in original action or in actions for enforcement of judgements of US courts, of certain civil liabilities, including those predicated solely upon the federal securities laws of the United States.

## RISK FACTORS

Set out below are certain risk factors which could affect the Lloyds TSB Group's future results and cause them to be materially different from expected results. The Lloyds TSB Group's results could also be affected by competition and other factors. The factors discussed below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties the Lloyds TSB Group's businesses face.

***Lloyds TSB Group's businesses are subject to inherent risks concerning borrower credit quality as well as general UK and international economic conditions. The development of adverse conditions in the UK or in other major economies could cause profitability to decline***

Lloyds TSB Group's businesses are subject to inherent risks regarding borrower credit quality as well as general UK economic conditions. Each of these can change the level of demand for, and supply of, Lloyds TSB Group's products and services. Changes in the credit quality of Lloyds TSB Group's UK and/or international borrowers and counterparties could reduce the value of Lloyds TSB Group's assets, and increase allowances for impairment losses. In addition, changes in economic conditions may result in a deterioration in the value of security held against lending exposures and increase the risk of loss in the event of borrower default. Furthermore, a general deterioration in the UK economy would also reduce Lloyds TSB Group's profit from both its UK banking and financial services businesses. A general deterioration in any other major world economy could also adversely impact Lloyds TSB Group's profitability. See "Operating and financial review and prospects" Risk management - Credit risk .

***Lloyds TSB Group's businesses are inherently subject to the risk of market fluctuations, which could reduce profitability***

Lloyds TSB Group's businesses are inherently subject to the risk of market fluctuations. The most significant market risks Lloyds TSB Group faces are those that impact the Group's pension schemes principally equity risk and interest rate risk; adverse market movements would have an effect upon the financial condition of the pension schemes which would be reflected in the Lloyds TSB Group's financial statements. Interest rate risk and foreign exchange risk arises from banking activities while equity risk is present in the insurance businesses. See "Operating and financial review and prospects" Risk management - Market risk for a discussion of these risks.

***Lloyds TSB Group's insurance businesses are subject to inherent risks relating to changing demographic developments, changing customer behaviour, adverse weather and similar contingencies outside its control. Development of adverse conditions could reduce profitability***

Lloyds TSB Group's insurance businesses are subject to inherent risk relating to changing demographic developments (including mortality), changing customer behaviour, adverse weather and similar contingencies outside its control, both in the UK and overseas. Such contingencies can change the risk profile and profitability of such products and services.

***Adverse experience in the operations risks inherent in Lloyds TSB Group's businesses could have a negative impact on its results of operations***

Operations risks are present in Lloyds TSB Group's businesses. Lloyds TSB Group's businesses are dependent on their ability to process accurately and efficiently a high volume of complex transactions across numerous and diverse products and services, in different currencies and subject to a number of different legal and regulatory regimes. Lloyds TSB Group's systems and processes are designed to ensure that the operations risks associated with its activities are appropriately controlled, but Lloyds TSB Group realises that any weakness in these systems could have a negative impact on its results of operations during the affected period. See "Operating and financial review and prospects" Risk management - Operational risk .

***Terrorist acts and other acts of war could have a negative impact on the business and results of operations of Lloyds TSB Group***

Terrorist acts, and other acts of war or hostility and responses to those acts, may create economic and political uncertainties, which could have a negative impact on UK and international economic conditions generally, and more specifically on the business and results of operations of Lloyds TSB Group in ways that cannot be predicted.

***Lloyds TSB Group's businesses are subject to substantial regulation, and regulatory and governmental oversight. Any significant adverse regulatory developments or changes in government policy could have a negative impact on Lloyds TSB Group's results of operations***

Lloyds TSB Group conducts its businesses subject to ongoing regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies, voluntary codes of practice and interpretations in the UK and the other markets where it operates. Future changes in regulation, fiscal or other policies are unpredictable and beyond the control of Lloyds TSB Group. For additional information, see "Regulation" .

In addition, in the UK and elsewhere, there is continuing political and regulatory scrutiny of banking and, in particular, retail banking. In the UK, the OFT is carrying out several inquiries, which are referred to in the "Competitive environment" section on page 11.

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In recent years there have been several issues in the UK financial services industry in which the FSA has intervened directly, including the sale of personal pensions and the sale of mortgage-related endowments. More recently, the FSA has carried out industry-wide investigations into sales of contracted-out pensions and sales and terms of reviewable

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policies. New areas of industry risk may be identified, or the FSA may intervene in relation to the areas of industry risk already identified, which could adversely affect the Lloyds TSB Group.

***Lloyds TSB Group is exposed to various forms of legal risk including the risk of mis-selling financial products, acting in breach of legal or regulatory principles or requirements and giving negligent advice, any of which could have a negative impact on its results or its relations with its customers***

Some of these issues involve the possibility of alleged mis-selling of retail financial products. There is a risk that further provisions may be required as a result of these issues.

Lloyds TSB Group is exposed to many forms of legal risk, which may arise in a number of ways. Primarily:

- i) certain aspects of the Lloyds TSB Group's business may be determined by the authorities, the Financial Ombudsman Service ("FOS") or the courts as not being conducted in accordance with applicable laws or, in the case of the FOS, what is fair and reasonable in the Ombudsman's opinion;
- ii) contractual obligations may either not be enforceable as intended or may be enforced against Lloyds TSB Group in an adverse way;
- iii) the intellectual property of Lloyds TSB Group (such as its trade names) may not be adequately protected; and
- iv) Lloyds TSB Group may be liable for damages to third parties harmed by the conduct of its business.

In addition, Lloyds TSB Group faces risk where legal proceedings or FOS complaints are brought against it. Regardless of whether or not such claims have merit, the outcome of such proceedings or complaints is inherently uncertain and if extended more broadly could have a material adverse effect on Lloyds TSB Group's operations and/or financial condition.

Although Lloyds TSB has policies around the management of legal risk, failure to manage legal risks could impact Lloyds TSB Group adversely, both financially and reputationally.

Tax risk is the risk associated with changes in, or errors in the interpretation of, taxation rates or law. This could result in increased charges or financial loss.

Although Lloyds TSB Group devotes considerable resources to managing tax risk, failure to manage this risk could impact Lloyds TSB Group adversely.

***Lloyds TSB Group's businesses are conducted in highly competitive environments. Creation of an appropriate return for shareholders depends upon management's ability to respond effectively to competitive pressures***

The market for UK financial services and the other markets within which Lloyds TSB Group operates are highly competitive, and management expects such competition to intensify in response to consumer demand, technological changes, the impact of consolidation, regulatory actions and other factors, which could result in a reduction in profit margins. Lloyds TSB Group's ability to generate an appropriate return for its shareholders depends significantly upon the competitive environment and management's response to it. See Business - Competitive environment .

***Lloyds TSB Group is devoting considerable time and resources to securing new customers and developing more business from existing customers. If Lloyds TSB Group is unsuccessful, its organic growth prospects will decline***

Lloyds TSB Group seeks to achieve further organic growth by securing new customers and developing more business from existing customers. Lloyds TSB Group is currently expending significant resources and effort to bring about this growth, particularly with respect to its UK retail financial services business. If these expenditures and efforts do not meet with success, its operating results would grow more slowly or decline.

***Lloyds TSB Group's strategic plans and related risks***

Lloyds TSB Group devotes considerable management and planning resources to developing strategic plans for organic growth and identifying possible acquisitions which would provide further opportunities for growth. If these strategic plans do not meet with success, Lloyds TSB Group's earnings could grow more slowly or decline.

Lloyds TSB Group's businesses are conducted in a marketplace that is consolidating and significant cross-border mergers and acquisitions may happen in the coming years. Lloyds TSB Group's ability to generate an appropriate return for its shareholders over the long-term may depend upon whether management is able to achieve value creating acquisitions and/or mergers at the appropriate times and prices. Lloyds TSB Group

cannot be sure that it will ultimately be able to make such mergers or acquisitions or that if it does, such mergers or acquisitions will be integrated successfully or realise anticipated benefits.



**FORWARD LOOKING STATEMENTS**

This annual report includes certain forward-looking statements with respect to the business, strategy and plans of Lloyds TSB Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Lloyds TSB Group's or management's beliefs and expectations, are forward-looking statements. Words such as believes, anticipates, estimates, expects, intends, aims, potential, will, could, considered, likely, estimate and variations of these expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future.

Examples of such forward-looking statements include, but are not limited to:

projections or expectations of profit attributable to shareholders, provisions, economic profit, dividends, capital structure or any other financial items or ratios;

statements of plans, objectives or goals of Lloyds TSB Group or its management;

statements about the future trends in interest rates, stock market levels and demographic trends and any impact on Lloyds TSB Group;

statements concerning any future UK or other economic environment or performance, including in particular any such statements included in this annual report in Operating and Financial Review and Prospects;

statements about strategic goals, competition, regulation, dispositions and consolidation or technological developments in the financial services industry; and

statements of assumptions underlying such statements.

Factors that could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements made by Lloyds TSB Group or on Lloyds TSB Group's behalf include, but are not limited to:

general economic conditions in the UK and internationally;

inflation, interest rate, exchange rate, market and monetary fluctuations;

changing demographic developments, adverse weather and similar contingencies outside the Lloyds TSB Group's control;

inadequate or failed internal or external processes, people and systems;

terrorist acts and other acts of war or hostility and responses to those acts;

changes in laws, regulations or taxation;

changes in competition and pricing environments;

the ability to secure new customers and develop more business from existing customers;

the ability to achieve value-creating mergers and/or acquisitions at the appropriate time and prices; and

the success of the Lloyds TSB Group in managing the risks of the foregoing.

Lloyds TSB Group plc may also make or disclose written and/or oral forward-looking statements in reports filed with or furnished to the US Securities and Exchange Commission, Lloyds TSB Group plc's annual report and accounts to shareholders, proxy statements, offering circulars, prospectuses, press releases and other written materials and in oral statements made by the directors, officers or employees of Lloyds TSB Group plc to third parties, including financial analysts. The forward-looking statements contained in this annual report are made as of the date hereof, and Lloyds TSB Group undertakes no obligation to update any of its forward-looking statements.

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### LLOYDS TSB GROUP STRUCTURE

The following is a list of the principal subsidiaries of Lloyds TSB Group plc at 31 December 2005. The audited consolidated accounts of Lloyds TSB Group plc for the year ended 31 December 2005 include the audited accounts of each of these companies.

| Name of subsidiary undertaking                       | Country of registration/<br>incorporation | Percentage of equity share capital and voting rights held | Nature of business                            | Registered office  |
|--|---|---|---|--|
| Lloyds TSB Bank plc                                  | England                                   | 100%  | Banking and financial services                | 25 Gresham Street London EC2V 7HN                          |
| Cheltenham & Gloucester plc                          | England                                   | 100%*   | Mortgage lending and retail investments       | Barnett Way Gloucester GL4 3RL                             |
| Lloyds TSB Commercial Finance Limited                | England                                   | 100%*   | Credit factoring                              | Beaumont House Beaumont Road, Banbury Oxfordshire OX16 7RN |
| Lloyds TSB Leasing Limited                           | England                                   | 100%*   | Financial leasing                             | 25 Gresham Street London EC2V 7HN                          |
| Lloyds TSB Private Banking Limited                   | England                                   | 100%*   | Private banking                               | 25 Gresham Street London EC2V 7HN                          |
| The Agricultural Mortgage Corporation PLC            | England                                   | 100%*   | Long-term agricultural finance                | Charlton Place Charlton Road Andover Hampshire SP10 1RE    |
| Lloyds TSB Offshore Limited                          | Jersey                                    | 100%*   | Banking and financial services                | 25 New Street St Helier Jersey JE4 8RG                     |
| Lloyds TSB Scotland plc                              | Scotland                                  | 100%*   | Banking and financial services                | Henry Duncan House 120 George Street Edinburgh EH2 4LH     |
| Lloyds TSB General Insurance Limited                 | England                                   | 100%*   | General insurance                             | 25 Gresham Street London EC2V 7HN                          |
| Scottish Widows Investment Partnership Group Limited | England                                   | 100%*   | Investment management                         | 10 Fleet Place London EC4M 7RH                             |
| Abbey Life Assurance Company Limited                 | England                                   | 100%*   | Life assurance                                | 80 Holdenhurst Road Bournemouth Dorset BH8 8ZQ             |
| Lloyds TSB Insurance Services Limited                | England                                   | 100%*   | Insurance broking                             | 25 Gresham Street London EC2V 7HN                          |
| Lloyds TSB Asset Finance Division Limited            | England                                   | 100%*   | Consumer credit, leasing and related services | 25 Gresham Street London EC2V 7HN                          |
| Black Horse Limited                                  | England                                   | 100%*   |   |  |

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Consumer credit,  
leasing and related  
services

25 Gresham Street London  
EC2V 7HN

|                                   |          |       |                |   |
|-----------------------------------|----------|-------|----------------|---|
| Scottish Widows plc               | Scotland | 100%* | Life assurance | 69 Morrison Street<br>Edinburgh EH3 8YF |
| Scottish Widows Annuities Limited | Scotland | 100%* | Life assurance | 69 Morrison Street<br>Edinburgh EH3 8YF |

\* Indirect interest

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## Report of the independent Registered Public Accounting Firm

To the Shareholders of Lloyds TSB Group plc:

We have audited the accompanying consolidated balance sheets of Lloyds TSB Group plc and its subsidiaries as of 31 December 2005 and 31 December 2004, and the related consolidated income statement, consolidated balance sheet, consolidated statement of changes in equity and consolidated cash flow statement for each of the two years in the period ended 31 December 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lloyds TSB Group plc and its subsidiary undertakings at 31 December 2005 and 31 December 2004, and the results of their operations and their cash flows for each of the two years in the period ended 31 December 2005 in conformity with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

As discussed in Note 1 Accounting Policies of the consolidated financial statements, the Group adopted International Accounting Standard (IAS) 32 Financial Instruments: Disclosure and Presentation, IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts in accordance with IFRS as adopted by the EU. The change has been accounted for with effect from 1 January 2005.

Accounting principles in conformity with IFRS as adopted by the EU vary in certain significant respects from accounting principles generally accepted in the United States. Information relating to the nature and effect of such differences is presented in Note 56 to the consolidated financial statements.

PricewaterhouseCoopers LLP  
Southampton, England

23 February 2006, except for Note 56, as to which the date is 6 June 2006.

## Consolidated income statement

for the year ended 31 December 2005

|   | Note | 2005<br>£ million | 2004<br>£ million |
|---|------|-------------------|-------------------|
| Interest and similar income                     |      | 12,589            | 10,707            |
| Interest and similar expense                    |      | (6,918)           | (5,597)           |
| <b>Net interest income</b>                      | 4    | <b>5,671</b>      | 5,110             |
| Fees and commission income                      |      | 2,990             | 3,054             |
| Fees and commission expense                     |      | (842)             | (844)             |
| Net fees and commission income                  | 5    | 2,148             | 2,210             |
| Net trading income                              | 6    | 9,298             | 5,036             |
| Insurance premium income                        | 7    | 4,469             | 6,070             |
| Other operating income                          | 8    | 1,140             | 857               |
| <b>Other income</b>                             |      | <b>17,055</b>     | 14,173            |
| <b>Total income</b>                             |      | <b>22,726</b>     | 19,283            |
| Insurance claims                                | 9    | (12,186)          | (9,622)           |
| <b>Total income, net of insurance claims</b>    |      | <b>10,540</b>     | 9,661             |
| Operating expenses                              | 10   | (5,471)           | (5,297)           |
| <b>Trading surplus</b>                          |      | <b>5,069</b>      | 4,364             |
| Impairment losses on loans and advances         | 11   | (1,299)           | (866)             |
| Profit (loss) on sale and closure of businesses | 12   | 50                | (21)              |
| <b>Profit before tax</b>                        |      | <b>3,820</b>      | 3,477             |
| Taxation  | 13   | (1,265)           | (1,018)           |
| <b>Profit for the year</b>                      |      | <b>2,555</b>      | 2,459             |
| Profit attributable to minority interests       |      | 62                | 67                |
| Profit attributable to equity shareholders      |      | 2,493             | 2,392             |
| <b>Profit for the year</b>                      |      | <b>2,555</b>      | 2,459             |
| <b>Basic earnings per share</b>                 | 14   | <b>44.6p</b>      | 42.8p             |
| <b>Diluted earnings per share</b>               | 14   | <b>44.2p</b>      | 42.5p             |

The accompanying notes are an integral part of the consolidated financial statements.

## Consolidated balance sheet

at 31 December 2005

|  | Note | 2005<br>£ million | 2004<br>£ million |
|--|------|-------------------|-------------------|
| <b>Assets</b>  |      |                   |                   |
| Cash and balances at central banks   |      | 1,156             | 1,078             |
| Items in the course of collection from banks                                       |      | 1,310             | 1,462             |
| Treasury bills and other eligible bills  | 15   |                   | 92                |
| Trading securities and other financial assets at fair value through profit or loss | 16   | 60,374            |                   |
| Derivative financial instruments   | 17   | 5,878             |                   |
| Loans and advances to banks  | 18   | 31,655            | 31,848            |
| Loans and advances to customers  | 19   | 174,944           | 155,318           |
| Debt securities  | 21   |                   | 43,485            |
| Equity shares  | 22   |                   | 27,310            |
| Available-for-sale financial assets  | 23   | 14,940            |                   |
| Investment property  | 24   | 4,260             | 3,776             |
| Goodwill   | 25   | 2,373             | 2,469             |
| Value of in-force business   | 26   | 2,922             | 4,363             |
| Other intangible assets  | 27   | 50                | 28                |
| Tangible fixed assets  | 28   | 4,291             | 4,180             |
| Other assets   | 30   | 5,601             | 9,013             |
| <b>Total assets</b>  |      | <b>309,754</b>    | <b>284,422</b>    |

The accompanying notes are an integral part of the consolidated financial statements.

## Consolidated balance sheet

at 31 December 2005

| <b>Equity and liabilities</b>   | Note | <b>2005</b><br>£ million | 2004<br>£ million |
|---|------|--------------------------|-------------------|
| <b>Liabilities</b>  |      |                          |                   |
| Deposits from banks   | 31   | 31,527                   | 39,723            |
| Customer accounts   | 32   | 131,070                  | 119,811           |
| Items in course of transmission to banks  |      | 658                      | 631               |
| Derivative financial instruments and other trading liabilities                      | 17   | 6,396                    |                   |
| Debt securities in issue  | 33   | 39,346                   | 28,770            |
| Liabilities arising from insurance contracts and participating investment contracts | 34   | 40,550                   | 52,289            |
| Liabilities arising from non-participating investment contracts                     | 35   | 21,839                   |                   |
| Unallocated surplus within insurance businesses                                     | 36   | 518                      | 1,362             |
| Other liabilities   | 37   | 9,843                    | 14,457            |
| Retirement benefit obligations  | 38   | 2,910                    | 3,075             |
| Current tax liabilities   |      | 552                      | 459               |
| Deferred tax liabilities  | 39   | 1,145                    | 1,704             |
| Other provisions  | 40   | 368                      | 211               |
| Subordinated liabilities  | 41   | 12,402                   | 10,252            |
| <b>Total liabilities</b>  |      | <b>299,124</b>           | 272,744           |
| <b>Equity</b>   |      |                          |                   |
| Share capital   | 42   | 1,420                    | 1,419             |
| Share premium account   | 43   | 1,170                    | 1,145             |
| Other reserves  | 44   | 383                      | 343               |
| Retained profits  | 45   | 7,222                    | 8,140             |
| <b>Shareholders equity</b>  |      | <b>10,195</b>            | 11,047            |
| Minority interests  | 48   | 435                      | 631               |
| <b>Total equity</b>   |      | <b>10,630</b>            | 11,678            |
| <b>Total equity and liabilities</b>   |      | <b>309,754</b>           | 284,422           |

The accompanying notes are an integral part of the consolidated financial statements.



## Consolidated statement of changes in equity

|   | Attributable to equity shareholders       |                                |                                  |                    |                                    |                    |
|---|---|--------------------------------|----------------------------------|--------------------|------------------------------------|--------------------|
|   | Share capital<br>and premium<br>£ million | Other<br>reserves<br>£ million | Retained<br>profits<br>£ million | Total<br>£ million | Minority<br>interests<br>£ million | Total<br>£ million |
| <b>Balance at 1 January 2004</b> (note 54)                          | 2,554                                     | 343                            | 7,646                            | 10,543             | 782                                | 11,325             |
| Currency translation differences                                    |   |                                | (12)                             | (12)               | 1                                  | (11)               |
| Profit for the year   |   |                                | 2,392                            | 2,392              | 67                                 | 2,459              |
| Total recognised income for 2004                                    |   |                                | 2,380                            | 2,380              | 68                                 | 2,448              |
| Dividends   |   |                                | (1,913)                          | (1,913)            | (68)                               | (1,981)            |
| Purchase/sale of treasury shares                                    |   |                                | 8                                | 8                  |                                    | 8                  |
| Employee share option schemes:                                      |   |                                |                                  |                    |                                    |                    |
| value of employee services  |   |                                | 19                               | 19                 |                                    | 19                 |
| proceeds from shares issued   | 10  |                                |                                  | 10                 |                                    | 10                 |
| Change in minority interests  |   |                                |                                  |                    | (151)                              | (151)              |
| <b>Balance at 31 December 2004</b> (note 54)                        | 2,564                                     | 343                            | 8,140                            | 11,047             | 631                                | 11,678             |
| Adjustments on transition to IAS 32, IAS 39<br>and IFRS 4 (note 54) |   | 28                             | (1,586)                          | (1,558)            | (550)                              | (2,108)            |
| <b>Restated balance at 1 January 2005</b> (note<br>54)              | <b>2,564</b>                              | <b>371</b>                     | <b>6,554</b>                     | <b>9,489</b>       | <b>81</b>                          | <b>9,570</b>       |
| Movement in available-for-sale financial<br>assets, net of tax      |   | 8                              |                                  | 8                  |                                    | 8                  |
| Movement in cash flow hedges, net of tax                            |   | 11                             |                                  | 11                 |                                    | 11                 |
| Currency translation differences                                    |   | (7)                            | 24                               | 17                 |                                    | 17                 |
| Net income recognised directly in equity                            |   | 12                             | 24                               | 36                 |                                    | 36                 |
| Profit for the year   |   |                                | 2,493                            | 2,493              | 62                                 | 2,555              |
| Total recognised income for 2005                                    |   | 12                             | 2,517                            | 2,529              | 62                                 | 2,591              |
| Dividends   |   |                                | (1,914)                          | (1,914)            | (37)                               | (1,951)            |
| Purchase/sale of treasury shares                                    |   |                                | 18                               | 18                 |                                    | 18                 |
| Employee share option schemes:                                      |   |                                |                                  |                    |                                    |                    |
| value of employee services  |   |                                | 47                               | 47                 |                                    | 47                 |
| proceeds from shares issued   | 26  |                                |                                  | 26                 |                                    | 26                 |
| Change in minority interests  |   |                                |                                  |                    | 329                                | 329                |
| <b>Balance at 31 December 2005</b>                                  | <b>2,590</b>                              | <b>383</b>                     | <b>7,222</b>                     | <b>10,195</b>      | <b>435</b>                         | <b>10,630</b>      |

The accompanying notes are an integral part of the consolidated financial statements.

## Consolidated cash flow statement

for the year ended 31 December 2005

|   | Note | 2005<br>£ million | 2004<br>£ million |
|---|------|-------------------|-------------------|
| <b>Net cash (used in) provided by operating activities</b>  | 53a  | <b>(331)</b>      | 12,214            |
| <b>Cash flows from investing activities:</b>  |      |                   |                   |
| Purchase of fixed asset investments   |      |                   | (10,088)          |
| Proceeds from sale and maturity of fixed asset investments  |      |                   | 9,732             |
| Purchase of available-for-sale financial assets   |      | <b>(10,108)</b>   |                   |
| Proceeds from sale and maturity of available-for-sale financial assets  |      | <b>10,266</b>     |                   |
| Purchase of fixed assets  |      | <b>(1,843)</b>    | (1,565)           |
| Proceeds from sale of fixed assets  |      | <b>1,073</b>      | 698               |
| Acquisition of businesses, net of cash acquired   | 53e  | <b>(27)</b>       | (16)              |
| Disposal of businesses, net of cash disposed  | 53f  | <b>(4)</b>        | (25)              |
| <b>Net cash used in investing activities</b>  |      | <b>(643)</b>      | (1,264)           |
| <b>Cash flows from financing activities:</b>  |      |                   |                   |
| Dividends paid to equity shareholders   |      | <b>(1,914)</b>    | (1,913)           |
| Dividends paid to minority interests  | 53d  | <b>(37)</b>       | (68)              |
| Proceeds from issue of subordinated liabilities   | 53d  | <b>1,361</b>      | 699               |
| Proceeds from issue of ordinary shares and transactions in own shares held in respect of employee share schemes | 53d  | <b>26</b>         | 11                |
| Repayment of subordinated liabilities (loan capital)  | 53d  | <b>(232)</b>      | (764)             |
| Capital element of finance lease rental payments  | 53d  | <b>(2)</b>        | (1)               |
| Change in minority investment in subsidiaries   | 53d  | <b>329</b>        | (151)             |
| <b>Net cash used in financing activities</b>  |      | <b>(469)</b>      | (2,187)           |
| Change in cash and cash equivalents   |      | <b>(1,443)</b>    | 8,763             |
| Cash and cash equivalents at beginning of year  |      | <b>28,196</b>     | 19,433            |
| <b>Cash and cash equivalents at end of year</b>   | 53b  | <b>26,753</b>     | 28,196            |

Cash and cash equivalents comprise cash and balances at central banks (excluding mandatory deposits) and amounts due from banks with a maturity of less than three months.

The accompanying notes are an integral part of the consolidated financial statements.

## Notes to the accounts

**1 Accounting policies**

In accordance with the requirements of Regulation (EC) No 1606/2002 of the European Parliament, the Group has applied International Financial Reporting Standards ( IFRS ) as adopted by the European Union (EU) in its financial statements for the year ended 31 December 2005. The rules for first time adoption of IFRS are set out in IFRS 1 First-time Adoption of International Financial Reporting Standards . On 1 January 2004, the date of transition, the opening IFRS balance sheet position has been determined in accordance with IFRS 1 which requires IFRS accounting policies to be applied on a retrospective basis with certain exceptions and exemptions detailed below.

| Mandatory exception  | Impact   |
|--|--|
| Estimates  | The Group's estimates at the date of transition are consistent with those under UK GAAP.   |
| Assets held for sale and discontinued operations                           | The Group has no transactions prior to 1 January 2005 that are affected by the transitional requirements of IFRS 5.  |
| Derecognition of financial instruments                                     | Financial instruments derecognised before 1 January 2004 have not been re-recognised by the Group under IFRS.  |
| Hedge accounting   | IFRS compliant hedge accounting is applied by the Group from 1 January 2005.   |
| Voluntary exemption  |  |
| Business combinations  | By electing to apply IFRS 3 on a prospective basis from 1 January 2004, the Group has not restated past acquisitions and mergers. Goodwill previously written off to reserves has not been reinstated and no additional intangible assets have been recognised in this regard.   |
| Retirement benefits  | Under UK GAAP, the Group has recognised all cumulative actuarial gains and losses and elects to apply this treatment at the date of transition to IFRS.  |
| Cumulative translation adjustment  | The Group has opted to reset the cumulative translation difference on adoption of IFRS to zero.  |
| Comparatives for financial instruments and designation of financial assets | The Group has chosen not to restate comparatives for IAS 32 and IAS 39, but to reflect the impact of these standards through adjustments to shareholders' equity as at 1 January 2005. At this date the Group has designated various financial assets as at fair value through profit or loss or as available-for-sale. The Group has applied UK GAAP to financial instruments and hedging transactions for its 2004 comparatives. |
| Share-based payments   | The Group has elected to apply IFRS 2 to equity instruments that were granted before 7 November 2002.  |
| Insurance contracts  | The Group has chosen not to restate its comparatives for IFRS 4 but to reflect the impact of this standard through adjustments to shareholders' equity at 1 January 2005. The Group has applied UK GAAP for its 2004 comparatives.   |

The Group has also adopted the requirements of Financial Reporting Standard ( FRS ) 27 Life Assurance issued by the UK Accounting Standards Board. FRS 27 has been applied from 1 January 2005; comparative figures have not been restated.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale financial assets, trading securities and other financial assets at fair value through profit or loss and all derivative contracts, on the basis of IFRS as adopted by the EU. IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board ( IASB ) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee and its predecessor body.

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The EU endorsed version of IAS 39 which is operative for years commencing 1 January 2005 relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation.

Further information on the principal differences between IFRS and FRS 27 and the Group's previous accounting policies and the effect of their adoption on the Group's previously published information is given in note 54.

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**1 Accounting policies** (continued)

The Group's accounting policies are set out below.

**(a) Consolidation**

The assets, liabilities and results of Group undertakings (including special purpose entities) are included in the financial statements on the basis of accounts made up to the reporting date. Group undertakings include all entities over which the Group has the power to govern the financial and operating policies which generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Group undertakings are fully consolidated from the date on which control is transferred to the Group; they are de-consolidated from the date that control ceases. Open Ended Investment Companies (OEICs) and unit trusts where the Group, through the Group's life funds, has a controlling interest are consolidated; the unit holders' interest is reported in other liabilities. Intra-Group transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

**(b) Goodwill**

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets of the acquired entity at the date of acquisition. Goodwill is recognised as an asset at cost and is tested at least annually for impairment. If an impairment is identified the carrying value of the goodwill is written down immediately through the income statement and is not subsequently reversed. At the date of disposal of a Group undertaking, the carrying value of attributable goodwill is included in the calculation of the profit or loss on disposal.

Goodwill arising on acquisitions prior to 1 January 2004, the date of transition to IFRS, has been retained at the balance sheet amount at that date and has been tested for impairment at that date. Goodwill previously written off directly to reserves under UK GAAP has not been reinstated and will not be included in calculating any subsequent profit or loss on disposal.

**(c) Revenue recognition**

Interest income and expense are recognised in the income statement for all interest-bearing financial instruments, including loans and advances, using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument and all other premiums or discounts. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss (see i).

Fees and commissions which are not an integral part of the effective interest rate are generally recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Loan syndication fees are recognised as revenue when the syndication has been completed and the Group retains no part of the loan package for itself or retains a part at the same effective interest rate for all interest-bearing financial instruments, including loans and advances, as for the other participants.

The Group receives investment management fees in respect of services rendered in conjunction with the issue and management of investment contracts where the Group actively manages the consideration received from its customers to fund a return that is based on the investment profile that the customer selected on origination of the instrument. These services comprise an indeterminate number of acts over the lives of the individual contracts and, therefore, the Group recognises these fees on a straight-line basis over the estimated lives of the contracts.

Revenue recognition policies specific to life assurance and general insurance business, except for investment management fees as noted above, are detailed below (see q).

**(d) Trading securities, other financial assets at fair value through profit or loss, and available-for-sale financial assets**

Debt securities and equity shares acquired principally for the purpose of selling in the short term or which are part of a portfolio which is managed for short-term gains are classified as trading securities and recognised in the balance sheet at their fair value. Gains and losses arising from changes in their fair value are recognised in the income statement in the period in which they occur.



**1 Accounting policies** (continued)

Other financial assets at fair value through profit or loss are designated as such by management upon initial recognition. Such assets are carried in the balance sheet at their fair value and gains and losses recognised in the income statement in the period in which they occur. Financial assets are only designated as at fair value through profit or loss when doing so results in more relevant information because it eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or losses on them on a different basis. No use is currently made of the option to designate financial liabilities at fair value through profit or loss.

The fair value of assets traded in active markets is based on current bid prices. If the market is not active the Group establishes a fair value by using valuation techniques. These include the use of recent arm's-length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Debt securities and equity shares, other than those classified as trading securities or at fair value through profit or loss, are classified as available-for-sale and recognised in the balance sheet at their fair value. Gains and losses arising from changes in the fair value of investments classified as available-for-sale are recognised directly in equity, until the financial asset is either sold, becomes impaired or matures, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement. Interest calculated using the effective interest method is recognised in the income statement; dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payment is established.

Purchases and sales of securities and other financial assets are recognised on trade date, being the date that the Group is committed to purchase or sell an asset. Trading securities and other financial assets at fair value through profit or loss are initially recognised at fair value. Available-for-sale financial assets are initially recognised at fair value inclusive of transaction costs. These financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

**(e) Loans and advances to banks and customers**

Loans and advances to banks and customers are accounted for at amortised cost using the effective interest method, except those which the Group intends to sell in the short term and which are accounted for at fair value, with the gains and losses arising from changes in their fair value reflected in the income statement. Loans and advances are initially recognised when cash is advanced to the borrowers at fair value inclusive of transaction costs. Loans and advances are derecognised when the rights to receive cash flows from them have expired or where the Group has transferred substantially all risks and rewards of ownership.

**(f) Sale and repurchase agreements**

Securities sold subject to repurchase agreements (repos) are reclassified in the financial statements as assets pledged when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in deposits from banks or customer accounts, as appropriate. Securities purchased under agreements to resell (reverse repos) are recorded as loans and advances to banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the obligation to return them is recorded at fair value as a trading liability.

**(g) Derivative financial instruments and hedge accounting**

All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative.

The method of recognising the movements in the fair value of the derivatives depends on whether they are designated as hedging instruments, and if so, the nature of the item being hedged. Derivatives may only be designated as hedges provided certain strict criteria are met. At the inception of a hedge its terms must be clearly documented and there must be an expectation that the derivative will be highly effective in offsetting changes in the fair value or cash flow of the hedged risk. The effectiveness of the hedging relationship must be tested throughout its life and if at any point it is concluded that it is no longer highly effective in achieving its objective the hedge relationship is terminated.

The Group designates certain derivatives as either: (1) hedges of the fair value of the interest rate risk inherent in recognised assets or liabilities (fair value hedges); or (2) hedges of highly probable future cash flows attributable to recognised assets or liabilities (cash flow hedges). These are accounted for as follows:





**1 Accounting policies** (continued)

*(1) Fair value hedges*

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged risk are no longer recognised in the income statement; the adjustment that has been made to the carrying amount of a hedged item is amortised to the income statement over the period to maturity.

*(2) Cash flow hedges*

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Changes in the fair value of any derivative instrument that is not part of a hedging relationship are recognised immediately in the income statement.

Derivatives embedded in financial instruments and insurance contracts (unless the embedded derivative is itself an insurance contract) are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

**(h) Offset**

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right of set-off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

**(i) Impairment**

*(1) Assets accounted for at amortised cost*

At each balance sheet date the Group assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset or group of financial assets has become impaired. Evidence of impairment may include indications that the borrower or group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, or the fact that the debt is being restructured to reduce the burden on the borrower.

If there is objective evidence that an impairment loss has been incurred, a provision is established which is calculated as the difference between the balance sheet carrying value of the asset and the present value of estimated future cash flows discounted at that asset's original effective interest rate. For the Group's portfolios of smaller balance homogenous loans, such as the residential mortgage, personal lending and credit card portfolios, provisions are calculated for groups of assets taking into account historical cash flow experience. For the Group's other lending portfolios, provisions are established on a case-by-case basis. If an asset has a variable interest rate, the discount rate used for measuring the impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised asset or group of assets reflects the cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

If there is no objective evidence of individual impairment the asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment. Segmentation takes into account such factors as the type of asset, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower's ability to pay all amounts due according to the contractual terms of the assets being evaluated. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

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If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, such as an improvement in the borrower's credit rating, the provision is adjusted and the amount of the reversal is recognised in the income statement.

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**1 Accounting policies** (continued)

When a loan or advance is uncollectable, it is written off against the related provision once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement.

*(2) Available-for-sale assets*

The Group assesses at each balance sheet date whether there is objective evidence that an available-for-sale asset is impaired. In addition to the factors set out above, a significant or prolonged decline in the fair value of the asset below its cost is considered in determining whether an impairment loss has been incurred. If an impairment loss has been incurred, the cumulative loss measured as the difference between the original cost and the current fair value, less any impairment loss on that asset previously recognised, is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

**(j) Investment property**

Property held for long-term rental yields and capital appreciation within the long-term assurance funds is classified as investment property. Investment property comprises freehold and long leasehold land and buildings and is carried in the balance sheet at fair value. Fair value is based on active market prices, adjusted, if necessary, for any difference in the nature, location or condition of the specific asset. If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices on less active markets. These valuations are reviewed at least annually by an independent valuation expert. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value. Changes in fair values are recorded in the income statement.

**(k) Tangible fixed assets**

Tangible fixed assets are included at cost less depreciation. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows:

Premises (excluding land):

Freehold/long and short leasehold premises: shorter of 50 years or the remaining period of the lease

Leasehold improvements: shorter of 10 years or the remaining period of the lease

Equipment:

Fixtures and furnishings: 10-20 years

Other equipment and motor vehicles: 3-8 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount it is written down immediately.

**(l) Leases**

*(1) As lessee*

The leases entered into by the Group are primarily operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

*(2) As lessor*

Assets leased to customers are classified as finance leases if the lease agreements transfer substantially all the risks and rewards of ownership to the lessee; all other leases are classified as operating leases. When assets are subject to finance leases, the present value of the lease payments is recognised as a receivable within loans and advances to banks and customers. Finance lease income is recognised over the term of the lease using the net investment method (before tax) reflecting a constant periodic rate of return.

Operating lease assets are included within fixed assets at cost and depreciated over the life of the lease after taking into account anticipated residual values. Operating lease rental income is recognised on a straight line basis over the life of the lease.

**1 Accounting policies** (continued)

**(m) Borrowings**

Borrowings are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost using the effective interest method.

Preference shares and other instruments which carry a mandatory coupon or are redeemable on a specific date are classified as financial liabilities. The coupon on these instruments is recognised in the income statement as interest expense.

**(n) Pensions and other post-retirement benefits**

The Group operates a number of post-retirement benefit schemes for its employees including both defined benefit and defined contribution pension plans. A defined benefit scheme is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, dependent on one or more factors such as age, years of service and salary. A defined contribution plan is a pension plan into which the Group pays fixed contributions; there is no legal or constructive obligation to pay further contributions.

Full actuarial valuations of the Group's principal defined benefit schemes are carried out every three years with interim reviews in the intervening years; these valuations are updated to 31 December each year by qualified independent actuaries, or in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows. For the purposes of these annual updates scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method adjusted for unrecognised actuarial gains and losses. The defined benefit scheme liabilities are discounted using rates equivalent to the market yields at the balance sheet date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. The resulting net surplus or deficit is included in the Group's balance sheet. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes.

The Group's income statement includes the current service cost of providing pension benefits, the expected return on the schemes' assets, net of expected administration costs, and the interest cost on the schemes' liabilities. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are not recognised unless the cumulative unrecognised gain or loss at the end of the previous reporting period exceeds the greater of 10 per cent of the scheme assets or liabilities. In these circumstances the excess is charged or credited to the income statement over the employees' expected average remaining working lives. Past-service costs are charged immediately to the income statement, unless the charges are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

The costs of the Group's defined contribution plans are charged to the income statement in the period in which they fall due.

**(o) Share-based compensation**

The Group operates a number of equity-settled, share-based compensation plans. The value of the employee services received in exchange for equity instruments granted under these plans is recognised as an expense over the vesting period of the instruments, with a corresponding increase in equity. This expense is determined by reference to the fair value of the number of equity instruments that are expected to vest. The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments at the date of grant is estimated using an appropriate valuation technique, such as a Black-Scholes option pricing model. The determination of fair values excludes the impact of any non-market vesting conditions, which are included in the assumptions used to estimate the number of options that are expected to vest. At each balance sheet date, this estimate is reassessed and if necessary revised. Any revision of the original estimate is recognised in the income statement over the remaining vesting period, together with a corresponding adjustment to equity.

**(p) Income taxes, including deferred income taxes**

Current income tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise.

For the Group's long-term assurance businesses, the tax charge is analysed between tax that is payable in respect of policyholders' returns and tax that is payable on equity holders' returns. This allocation is based on an assessment of the rates of tax which will be applied to the returns under current UK tax rules.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred income tax is not accounted for if it arises from initial

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recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

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**1 Accounting policies** (continued)

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax is provided on temporary differences arising from investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future. Income tax payable on profits is recognised as an expense in the period in which those profits arise. The tax effects of losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised. Deferred tax related to fair value re-measurement of available-for-sale investments and cash flow hedges, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement together with the deferred gain or loss.

Deferred and current tax assets and liabilities are offset when they arise in the same tax reporting group and where there is both a legal right of offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

**(q) Insurance**

The Group undertakes both life assurance and general insurance business. The general insurance business issues insurance contracts only. The life assurance business issues insurance contracts and investment contracts. Insurance contracts are those contracts which transfer significant insurance risk. As a general guideline, the Group defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event which are more than the benefits payable if the insured event were not to occur. Investment contracts are those contracts which carry no significant insurance risk.

A number of insurance and investment contracts contain a discretionary participation feature which entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses that are likely to be a significant portion of the total contractual benefits and whose amount or timing is contractually at the discretion of the Group and based on the performance of specified assets. Contracts containing a discretionary participation feature are referred to as participating contracts.

IFRS 4 allows entities to continue with existing accounting policies for insurance and participating investment contracts, subject to certain criteria; the Group continues to apply UK GAAP for such contracts. For insurance and participating contracts issued by the life assurance business, this includes continued application of the embedded value basis of accounting although, as described below, the underlying contracts are presented separately from the value of in-force life assurance business in respect of those contracts. Investment contracts that are non-participating are accounted for as financial instruments.

**(1) Life assurance business**

*(i) Accounting for life insurance contracts and participating investment contracts*

The majority of the life insurance contracts issued by the Group are long-term life assurance contracts. The Group also issues life insurance contracts to protect customers from the consequences of events (such as death, critical illness or disability) that would affect the ability of the customer or their dependants to maintain their current level of income. Guaranteed claims paid on occurrence of the specified insurance event are either fixed or linked to the extent of the economic loss suffered by the policyholder.

*Premiums and claims*

Premiums received in respect of life insurance contracts and participating investment contracts are recognised as revenue when due and are shown before deduction of commission.

Claims are recorded as an expense when they are incurred.

*Liabilities*

*life insurance contracts or participating investment contracts in the Group's With-Profits Fund*

Liabilities of the Group's With-Profits Fund, including guarantees and options embedded within products written by that fund, are stated at their realistic values in accordance with the Financial Services Authority's realistic capital regime.

*life insurance contracts or participating investment contracts which are not unit-linked or in the Group's With-Profits Fund*

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A liability for contractual benefits that are expected to be incurred in the future is recorded when the premiums are recognised. The liability is calculated by estimating the future cash flows over the duration of in-force policies and discounting them back to the valuation date allowing for probabilities of occurrence. The liability will vary with movements in interest rates and with the cost of life assurance and annuity benefits where future mortality is uncertain. Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs.

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**1 Accounting policies** (continued)

*life insurance contracts or participating investment contracts which are unit-linked*

Allocated premiums in respect of unit-linked contracts that are either life insurance contracts or participating investment contracts are recognised as liabilities. These liabilities are increased or reduced by the change in the unit prices and are reduced by policy administration fees, mortality and surrender charges and any withdrawals. The mortality charges deducted in each period from the policyholders as a group are considered adequate to cover the expected total death benefit claims in excess of the contract account balances in each period and hence no additional liability is established for these claims. Revenue consists of fees deducted for mortality, policy administration and surrender charges. Interest or changes in the unit prices credited to the account balances and excess benefit claims in excess of the account balances incurred in the period are charged as expenses in the income statement.

*Unallocated surplus*

The Group has an obligation to pay policyholders a specified portion of all interest and realised gains and losses arising from the assets backing participating contracts. Any amounts not yet determined as being due to policyholders are recognised as an unallocated surplus which is shown separately from other liabilities.

*Value of in-force life assurance business*

The Group recognises as an asset the value of in-force life assurance business in respect of life insurance contracts and participating investment contracts. The asset, which represents the present value of future profits expected to arise from these contracts, is determined by projecting the future surpluses and other cash flows arising from life insurance contract and participating investment contract business written by the balance sheet date but excluding any future investment margins, using appropriate economic and actuarial assumptions; the value of future cash flows on with-profits policies has been reduced, where necessary, to allow for the realistic value of options and guarantees. The result is discounted at a rate which removes investment risk margins and reflects the Group's overall risk premium attributable to this business. The asset in the consolidated balance sheet is shown gross of attributable tax and movements in the asset are reflected within other operating income in the income statement.

*Receivables and payables*

Receivables and payables are recognised when due. These include amounts due to and from agents, brokers and insurance contract holders.

**(ii) Accounting for non-participating investment contracts**

All of the Group's non-participating investment contracts are unit-linked. In accordance with industry practice, these contracts are accounted for as financial liabilities whose value is contractually linked to the fair values of financial assets within the Group's unitised investment funds. The value of the unit-linked financial liabilities is determined using current unit prices multiplied by the number of units attributed to the contract holders at the balance sheet date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable.

The element of premiums and claims in respect of non-participating investment contracts which is invested on behalf of the contract holder is excluded from the income statement, with all movements in the contract holder liability and related assets recorded in the balance sheet. Details of the basis of revenue recognition for the related investment management fees are set out above (see c).

Directly incremental commissions that vary with and are related to either securing new or renewing existing non-participating investment contracts are deferred; all other costs are recognised as expenses when incurred. This asset is subsequently amortised over the period of the provision of investment management services and is reviewed for impairment in circumstances where its carrying amount may not be recoverable. If the asset is greater than its recoverable amount it is written down immediately.

**(2) General insurance business**

The Group both underwrites and acts as intermediary in the sale of general insurance products. Underwriting premiums are included, net of refunds, in the period in which insurance cover is provided to the customer; premiums received relating to future periods are deferred and only credited to the income statement when earned. Broking commission is recognised when the underwriter accepts the risk of providing insurance cover to the customer. Where appropriate, provision is made for the effect of future policy terminations based upon past experience.

The underwriting business makes provision for the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the

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outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date.

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**1 Accounting policies** (continued)

**(3) Liability adequacy test**

At each balance sheet date liability adequacy tests are performed to ensure the adequacy of insurance and participating investment contract liabilities. In performing these tests current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to profit or loss by establishing a provision for losses arising from liability adequacy tests.

**(4) Reinsurance**

Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on one or more contracts issued by the Group and that meet the classification requirements for insurance contracts are classified as reinsurance contracts held. Insurance contracts entered into by the Group under which the contract holder is another insurer (inwards reinsurance) are included with insurance contracts.

The benefits to which the Group is entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers as well as longer term receivables that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

**(r) Foreign currency translation**

*(1) Functional and presentation currency*

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in sterling, which is the Company's functional and presentation currency.

*(2) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges. Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are included in the fair value reserve in equity.

*(3) Group companies*

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- (ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- (iii) all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities are taken to shareholders' equity. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

**(s) Provisions**

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Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

The Group recognises provisions in respect of vacant leasehold property where the unavoidable costs of the present obligations exceed anticipated rental income.

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**1 Accounting policies** (continued)

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

**(t) Dividends**

Dividends on ordinary shares are recognised in equity in the period in which they are paid.

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## **2 Critical accounting estimates and judgements**

The Group makes assumptions and estimates that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The accounting policies deemed critical to the Group's results and financial position, based upon materiality and significant judgements and estimates, are discussed below.

### **Impairment on assets accounted for at amortised cost**

The Group regularly reviews its loan portfolios to assess for impairment. In determining whether an impairment has occurred the Group considers whether there is any observable data indicating that there has been a measurable decrease in the estimated future cash flows and their timings; such observable data includes whether there has been an adverse change in the payment status of borrowers or changes in economic conditions that correlate with defaults on assets in the Group.

The methodology used to calculate the required provision varies according to the type of lending portfolio. For portfolios of smaller balance homogenous loans, such as residential mortgages, personal loans and credit card balances, impairment provisions are calculated collectively using formulae which take into account factors such as the length of time that the customer's account has been delinquent, historical loss rates and the value of any collateral held in order to determine expected future cash flows. The variables used in the formulae are kept under regular review to ensure that as far as possible they reflect the current economic circumstances, although actual experience may differ from that assumed.

For other lending portfolios, provisions are calculated on an individual basis with reference to expected future cash flows including those arising from the realisation of collateral. The determination of these provisions often requires the exercise of considerable judgement by management involving matters such as future economic conditions and the resulting trading performance of the customer and the value of collateral, for which there may not be a readily accessible market. As a result these provisions can be subject to significant variation as time progresses and the circumstances of the customer become clearer.

The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

### **Pensions**

The net liability recognised in the balance sheet in respect of the Group's retirement benefit obligations represents the liabilities of the Group's defined benefit pension schemes after deduction of the fair value of the related assets. The schemes' liabilities are derived by estimating the ultimate cost of benefits payable by the schemes and reflecting the discounted value of the proportion accrued by the year end in the balance sheet. In order to arrive at this estimate a number of key financial and non-financial assumptions are made by management, changes to which could have a material impact upon the net deficit and also the net cost recognised in the income statement.

The principal assumptions relate to the rate of inflation, mortality and the discount rate. The assumed rate of inflation is important because this affects the rate at which salaries grow and therefore the size of the pension that employees receive upon retirement. Over the longer term rates of inflation can vary significantly; at 31 December 2005 it was assumed that the longer term rate of inflation would be 2.7 per cent on average, although if this was increased by 0.2 per cent the net deficit would increase by approximately £600 million and the net cost by approximately £15 million. A reduction of 0.2 per cent would reduce the net deficit by approximately £575 million and the net cost by approximately £20 million.

The overall cost of the benefits payable by the schemes will also depend upon the length of time that members of the schemes live for; the longer they remain alive the higher the cost of the pension benefits to be met by the schemes. Assumptions are made regarding the expected lifetime of scheme members based upon recent experience, however given the rates of advance in medical science it is uncertain whether these assumptions will prove to be accurate in practice. An increase of one year in the expected lifetime of scheme members would increase the net deficit by approximately £450 million and the net cost by approximately £30 million; a reduction of one year reduces the net deficit and the net cost by similar amounts.

The rate used to discount the resulting cash flows is equivalent to the market yield at the balance sheet date on high quality bonds with a similar duration to the schemes' liabilities. This rate is potentially subject to significant variation. At 31 December 2005 the discount rate used was 4.8 per cent; a reduction of 0.2 per cent would result in an increase in the net deficit of approximately £650 million and in the net cost of approximately £15 million, while an increase of 0.2 per cent would reduce the net deficit by approximately £600 million and the net cost by approximately £15 million.

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The net cost recognised in the income statement is also affected by the expected return on the schemes' assets. This is determined on the basis of the asset mix within the schemes at the beginning of the year and market expectations for the return on each asset type. During 2005 the assumed return on equities was 8.2 per cent; a 0.25 per cent increase or decrease in the assumed return on equities increases or decreases the expected return reflected in the income statement by approximately £20 million.

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**2 Critical accounting estimates and judgements** (continued)

**Goodwill**

The Group reviews the goodwill arising on the acquisition of subsidiaries for impairment at least annually or when events or changes in economic circumstances indicate that impairment may have taken place. The impairment review is performed by projecting future cash flows, excluding finance and tax, based upon budgets and plans and making appropriate assumptions about rates of growth and discounting these using a rate that takes into account prevailing market interest rates and the risks inherent in the business. If the present value of the projected cash flows is less than the carrying value of the underlying net assets and related goodwill an impairment charge would be required in the income statement. This calculation requires the exercise of significant judgement by management; if the estimates made prove to be incorrect or changes in the performance of the subsidiaries affect the amount and timing of future cash flows, goodwill may become impaired in future periods.

**Customer remediation provisions**

The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, in those cases where the original sales processes are found to have been deficient. The ultimate cost is inherently uncertain and in determining the level of provisions required it is necessary for management to exercise significant judgement. The principal assumptions underlying the provisions relate to the number of cases requiring redress and the estimated average cost of redress per case; these will be affected by external factors beyond the control of management, such as regulatory actions and the performance of the financial markets. Therefore over time it is possible that adjustments will be necessary to the level of provisions held.

**Insurance**

*Life assurance business*

Calculation of the value of in-force life assurance business assets and life assurance business policy liabilities are dependent on assumptions made regarding future experience. If actual experience differs from that assumed, this could significantly affect the value attributed to these items. Any profit or loss arising from such changes would be recognised in the income statement in that period. The key assumptions upon which these items are dependent are described in notes 26 and 34, along with the impact on profit before tax which would occur if they were to change.

*General insurance business*

A provision is made for the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date.

While management believes that the liability carried at year end is adequate, the application of statistical techniques requires significant judgment. An increase of 10 per cent in the cost of claims would result in the recognition of an additional loss of approximately £14 million. Similarly, an increase of 10 per cent in the ultimate number of such claims would lead to an additional loss of approximately £15 million. There is no relief arising from reinsurance contracts held.

**Income taxes**

Significant judgement is required in determining the Group's income tax liabilities. There are many transactions and calculations for which the ultimate tax determination is uncertain and where calculations have been based on management's assessment of legal and professional advice, case law and other relevant guidance. In these situations, the various risks are categorised and approximate weightings applied in arriving at the assessment of the expected liability. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred tax amounts in the period in which such determination is made.



### 3 Segmental analysis

Lloyds TSB Group is a leading UK-based financial services group, whose businesses provide a wide range of banking and financial services in the UK and in certain locations overseas.

The Group's activities are organised into three segments: UK Retail Banking, Insurance and Investments and Wholesale and International Banking. Services provided by UK Retail Banking encompass the provision of banking and other financial services to personal customers, private banking, stockbroking and mortgages. Insurance and Investments offers life assurance, pensions and savings products, general insurance and asset management services. Wholesale and International Banking provides banking and related services for major UK and multinational companies, banks and financial institutions, and small and medium-sized UK businesses. It also provides asset finance to personal and corporate customers, manages the Group's activities in financial markets through its Treasury function and provides banking and financial services overseas.

Under the Group's transfer pricing arrangements, inter-segment services are generally recharged at cost, with the exception of the internal commission arrangements between the UK branch and other distribution networks and the insurance product manufacturing businesses within the Group, where a profit margin is also charged. Inter-segment lending and deposits are generally entered into at market rates, except that non-interest bearing balances are priced at a rate that reflects the external yield that could be earned on such funds. In addition, with effect from 1 January 2005, for those derivative contracts entered into by business units for risk management purposes, the difference between the result that would have been recognised on an accruals accounting basis and the actual result calculated using fair values is charged or credited to the central segment where the resulting volatility is managed.

| Year ended 31 December 2005                         | UK<br>Retail<br>Banking<br>£m | General<br>insurance<br>£m | Life,<br>pensions<br>and asset<br>management<br>£m | Insurance<br>and<br>Investment<br>£m | Wholesale<br>and<br>International<br>Banking<br>£m | Central<br>group<br>items<br>£m | Inter-<br>segment<br>eliminations<br>£m | Total<br>£m |
|---|-------------------------------|----------------------------|--|--------------------------------------|--|---------------------------------|---|-------------|
| Interest and similar income                         | 6,652                         | 27                         | 850  | 877                                  | 6,944  | 1,091                           | (2,975)                                 | 12,589      |
| Interest and similar expense                        | (3,131)                       | (4)                        | (478)  | (482)                                | (4,679)  | (1,601)                         | 2,975                                   | (6,918)     |
| Net interest income                                 | 3,521                         | 23                         | 372  | 395                                  | 2,265  | (510)                           |   | 5,671       |
| Other income (net of fee and<br>commission expense) | 1,605                         | 571                        | 13,288   | 13,859                               | 1,628  | (37)                            |   | 17,055      |
| Total income  | 5,126                         | 594                        | 13,660   | 14,254                               | 3,893  | (547)                           |   | 22,726      |
| Insurance claims                                    |                               | (197)                      | (11,989)   | (12,186)                             |  |                                 |   | (12,186)    |
| Total income, net of insurance<br>claims            | 5,126                         | 397                        | 1,671  | 2,068                                | 3,893  | (547)                           |   | 10,540      |
| Operating expenses                                  | (2,697)                       | (160)                      | (434)  | (594)                                | (2,181)  | 1                               |   | (5,471)     |
| Trading surplus                                     | 2,429                         | 237                        | 1,237  | 1,474                                | 1,712  | (546)                           |   | 5,069       |
| Impairment losses on loans<br>and advances          | (1,111)                       |                            |  |                                      | (188)  |                                 |   | (1,299)     |
| Profit (loss) on sale and<br>closure of businesses  | 76                            |                            |  |                                      | (6)  | (20)                            |   | 50          |
| Profit (loss) before tax                            | 1,394                         | 237                        | 1,237  | 1,474                                | 1,518  | (566)                           |   | 3,820       |
| External revenue                                    | 7,833                         | 1,272                      | 14,127   | 15,399                               | 7,283  | (29)                            |   | 30,486      |
| Inter-segment revenue                               | 744                           | 16                         | 330  | 346                                  | 1,686  | 1,175                           | (3,951)                                 |             |
| Segment revenue                                     | 8,577                         | 1,288                      | 14,457   | 15,745                               | 8,969  | 1,146                           | (3,951)                                 | 30,486      |
| External assets                                     | 103,930                       | 968                        | 79,180   | 80,148                               | 124,044  | 1,632                           |   | 309,754     |
| Inter-segment assets                                | 2,146                         | 593                        | 3,893  | 4,486                                | 81,728   | 50,855                          | (139,215)                               |             |

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|                                   |         |       |        |        |         |        |           |         |
|-----------------------------------|---------|-------|--------|--------|---------|--------|-----------|---------|
| Total assets                      | 106,076 | 1,561 | 83,073 | 84,634 | 205,772 | 52,487 | (139,215) | 309,754 |
| External liabilities              | 72,335  | 829   | 71,894 | 72,723 | 141,878 | 12,188 |           | 299,124 |
| Inter-segment liabilities         | 30,492  | 280   | 5,133  | 5,413  | 59,224  | 44,086 | (139,215) |         |
| Total liabilities                 | 102,827 | 1,109 | 77,027 | 78,136 | 201,102 | 56,274 | (139,215) | 299,124 |
| Other segment items:              |         |       |        |        |         |        |           |         |
| Capital expenditure               | 77      | 13    | 844    | 857    | 702     | 207    |           | 1,843   |
| Depreciation                      | 219     | 11    | 26     | 37     | 383     |        |           | 639     |
| Customer remediation provision    | 150     |       |        |        |         |        |           | 150     |
| Retirement benefit scheme charges | 134     | 4     | 22     | 26     | 84      | 15     |           | 259     |

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3 Segmental analysis (continued)

| Year ended 31 December 2004                         | UK<br>Retail<br>Banking<br>£m | General<br>insurance<br>£m | Life,<br>pensions<br>and asset<br>management<br>£m | Insurance<br>and<br>Investment<br>£m | Wholesale<br>and<br>International<br>Banking<br>£m | Central<br>group<br>items<br>£m | Inter-<br>segment<br>eliminations<br>£m | Total<br>£m |
|---|-------------------------------|----------------------------|--|--------------------------------------|--|---------------------------------|---|-------------|
| Interest and similar income                         | 5,825                         | 56                         | 537  | 593                                  | 5,954  | 883                             | (2,548)                                 | 10,707      |
| Interest and similar expense                        | (2,597)                       | (12)                       | (298)  | (310)                                | (3,948)  | (1,290)                         | 2,548                                   | (5,597)     |
| Net interest income                                 | 3,228                         | 44                         | 239  | 283                                  | 2,006  | (407)                           |   | 5,110       |
| Other income (net of fee and<br>commission expense) | 1,696                         | 504                        | 10,370   | 10,874                               | 1,558  | 45                              |   | 14,173      |
| Total income  | 4,924                         | 548                        | 10,609   | 11,157                               | 3,564  | (362)                           |   | 19,283      |
| Insurance claims                                    |                               | (214)                      | (9,408)  | (9,622)                              |  |                                 |   | (9,622)     |
| Total income, net of insurance<br>claims            | 4,924                         | 334                        | 1,201  | 1,535                                | 3,564  | (362)                           |   | 9,661       |
| Operating expenses                                  | (2,609)                       | (154)                      | (468)  | (622)                                | (2,078)  | 12                              |   | (5,297)     |
| Trading surplus                                     | 2,315                         | 180                        | 733  | 913                                  | 1,486  | (350)                           |   | 4,364       |
| Impairment losses on loans and<br>advances          | (676)                         |                            | 3  | 3                                    | (193)  |                                 |   | (866)       |
| Loss on sale of businesses                          |                               |                            |  |                                      | (21)   |                                 |   | (21)        |
| Profit (loss) before tax                            | 1,639                         | 180                        | 736  | 916                                  | 1,272  | (350)                           |   | 3,477       |
| External revenue                                    | 7,089                         | 1,288                      | 11,121   | 12,409                               | 6,135  | 91                              |   | 25,724      |
| Inter-segment revenue                               | 791                           | 48                         | 19   | 67                                   | 1,716  | 851                             | (3,425)                                 |             |
| Segment revenue                                     | 7,880                         | 1,336                      | 11,140   | 12,476                               | 7,851  | 942                             | (3,425)                                 | 25,724      |
| External assets                                     | 96,763                        | 1,058                      | 70,874   | 71,932                               | 114,086  | 1,641                           |   | 284,422     |
| Inter-segment assets                                | 1,340                         | 526                        | 2,644  | 3,170                                | 70,947   | 39,503                          | (114,960)                               |             |
| Total assets  | 98,103                        | 1,584                      | 73,518   | 75,102                               | 185,033  | 41,144                          | (114,960)                               | 284,422     |
| External liabilities                                | 68,149                        | 931                        | 62,305   | 63,236                               | 130,171  | 11,188                          |   | 272,744     |
| Inter-segment liabilities                           | 27,035                        | 75                         | 4,105  | 4,180                                | 50,643   | 33,102                          | (114,960)                               |             |
| Total liabilities                                   | 95,184                        | 1,006                      | 66,410   | 67,416                               | 180,814  | 44,290                          | (114,960)                               | 272,744     |
| Other segment items:                                |                               |                            |  |                                      |  |                                 |   |             |
| Capital expenditure                                 | 103                           |                            | 386  | 386                                  | 907  | 169                             |   | 1,565       |
| Depreciation  | 217                           | 11                         | 25   | 36                                   | 385  |                                 |   | 638         |
| Customer remediation<br>provision                   | 100                           | 12                         |  | 12                                   |  |                                 |   | 112         |
| Retirement benefit scheme<br>charges                | 142                           | 3                          | 24   | 27                                   | 90   | 16                              |   | 275         |

As the activities of the Group are predominantly carried out in the UK, no geographical analysis is presented.

**4 Net interest income**

|  | 2005<br>Average<br>effective<br>interest rate<br>% | 2005<br>£m     | 2004<br>£m |
|--|--|----------------|------------|
| <b>Interest receivable:</b>                      |  |                |            |
| Treasury bills and other eligible bills          |  |                | 6          |
| Investment securities                            |  |                | 418        |
| Available-for-sale financial assets              | 3.58   | 508            |            |
| Loans and advances to customers                  | 6.41   | 10,095         | 8,440      |
| Loans and advances to banks                      | 3.59   | 1,199          | 979        |
| Lease and hire purchase receivables              | 7.07   | 787            | 864        |
|  | <b>5.82</b>  | <b>12,589</b>  | 10,707     |
| <b>Interest payable:</b>                         |  |                |            |
| Deposits from banks                              | 3.44   | (953)          | (558)      |
| Customer accounts                                | 2.84   | (3,401)        | (3,003)    |
| Debt securities in issue                         | 4.23   | (1,307)        | (972)      |
| Subordinated liabilities                         | 5.22   | (601)          | (601)      |
| Liabilities under sale and repurchase agreements | 4.53   | (394)          | (319)      |
| Other  | 7.24   | (262)          | (144)      |
|  | <b>3.42</b>  | <b>(6,918)</b> | (5,597)    |
| <b>Net interest income</b>                       |  | <b>5,671</b>   | 5,110      |

Included within interest income in 2005 is £209 million in respect of impaired financial assets.

**5 Net fees and commission income**

|                                     | 2005<br>£m   | 2004<br>£m |
|-------------------------------------|--------------|------------|
| <b>Fees and commission income:</b>  |              |            |
| Current accounts                    | 593          | 637        |
| Insurance broking                   | 681          | 672        |
| Credit and debit card services      | 545          | 520        |
| Other                               | 1,171        | 1,225      |
|                                     | <b>2,990</b> | 3,054      |
| <b>Fees and commission expense:</b> |              |            |
| Credit and debit card services      | (182)        | (176)      |
| Dealer commissions                  | (247)        | (272)      |
| Other                               | (413)        | (396)      |
|                                     | <b>(842)</b> | (844)      |

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|                                |              |       |
|--------------------------------|--------------|-------|
| Net fees and commission income | <b>2,148</b> | 2,210 |
|--------------------------------|--------------|-------|

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**6 Net trading income**

|  | <b>2005</b>  | 2004  |
|--|--------------|-------|
|  | <b>£m</b>    | £m    |
| Foreign exchange translation gains             | <b>13</b>    | 22    |
| Gains on foreign exchange trading transactions | <b>150</b>   | 152   |
| Total foreign exchange                         | <b>163</b>   | 174   |
| Investment property gains                      | <b>430</b>   | 329   |
| Securities and other gains                     | <b>8,705</b> | 4,533 |
|  | <b>9,298</b> | 5,036 |

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**7 Insurance premium income**

The table below reflects the insurance premiums, substantially all of which relate to business written in the United Kingdom, broken down into life insurance and non-life insurance:

|   | 2005<br>£m | 2004<br>£m |
|---|------------|------------|
| <i>Life insurance</i>                     |            |            |
| Gross premiums                            | 3,996      | 5,581      |
| Ceded reinsurance premiums                | (89)       | (65)       |
| Net premiums earned                       | 3,907      | 5,516      |
| <i>Non-life insurance</i>                 |            |            |
| Gross premiums written                    | 575        | 635        |
| Ceded reinsurance premiums                | (22)       | (29)       |
| Net premiums                              | 553        | 606        |
| Change in provision for unearned premiums | 9          | (52)       |
| Net premiums earned                       | 562        | 554        |
| Total net premiums earned                 | 4,469      | 6,070      |

Life insurance gross written premiums can be further analysed as follows:

|                | 2005<br>£m | 2004<br>£m |
|----------------|------------|------------|
| Life           | 1,286      | 2,100      |
| Pensions       | 2,136      | 2,826      |
| Annuities      | 547        | 626        |
| Other          | 27         | 29         |
| Gross premiums | 3,996      | 5,581      |

Non-life insurance gross written premiums can be further analysed as follows:

|                   | 2005<br>£m | 2004<br>£m |
|-------------------|------------|------------|
| Credit protection | 173        | 224        |
| Home              | 390        | 396        |
| Health            | 12         | 15         |
|                   | 575        | 635        |

**8 Other operating income**

|  | 2005<br>£m | 2004<br>£m |
|--|------------|------------|
|--|------------|------------|

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|  |              |     |
|--|--------------|-----|
| Operating lease rental income  | 433          | 422 |
| Income from investment property  | 272          | 158 |
| Other rents receivable   | 30           | 32  |
| Gains less losses on disposal of available-for-sale financial assets, net of allowances for impairment | 5            |     |
| Gains less losses on disposal of investment securities, net of amounts written off                     |              | 74  |
| Movement in value of in-force insurance business (note 26)   | 162          | 16  |
| Other income   | 238          | 155 |
|  | <b>1,140</b> | 857 |

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**9 Insurance claims**

Insurance claims comprise:

|  | 2005<br>£m    | 2004<br>£m   |
|--|---------------|--------------|
| <i>Life insurance</i>  |               |              |
| Claims and surrenders:                                       |               |              |
| Gross  | 4,279         | 5,242        |
| Reinsurers' share  | (56)          | (62)         |
|  | 4,223         | 5,180        |
| Changes in life insurance policyholder liabilities:          |               |              |
| Gross  | 7,641         | 3,206        |
| Reinsurers' share  | 33            | (1)          |
|  | 7,674         | 3,205        |
| Change in unallocated surplus                                | 92            | 1,023        |
| <b>Total life insurance</b>                                  | <b>11,989</b> | <b>9,408</b> |
| <i>Non-life insurance</i>                                    |               |              |
| Claims and claims paid:                                      |               |              |
| Gross  | 195           | 204          |
| Reinsurers' share  | (1)           | (1)          |
|  | 194           | 203          |
| Changes in non-life insurance policyholder liabilities:      |               |              |
| Gross  | 3             | 11           |
| Reinsurers' share  | 3             | 11           |
| <b>Total non-life insurance</b>                              | <b>197</b>    | <b>214</b>   |
| <b>Total insurance claims expense</b>                        | <b>12,186</b> | <b>9,622</b> |
| Life insurance gross claims can also be analysed as follows: |               |              |
| Deaths   | 298           | 354          |
| Maturities   | 1,197         | 1,617        |
| Surrenders   | 2,204         | 2,700        |
| Annuities  | 528           | 528          |
| Other  | 52            | 43           |
|  | 4,279         | 5,242        |

A non-life insurance claims development table is included in note 34.

**10 Operating expenses**

|                                | 2005<br>£m   | 2004<br>£m   |
|--------------------------------|--------------|--------------|
| Salaries                       | 2,068        | 1,970        |
| Pensions                       | 308          | 307          |
| Other staff costs              | 479          | 427          |
| <b>Staff costs</b>             | <b>2,855</b> | <b>2,704</b> |
| Other administrative expenses: |              |              |



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|   |              |       |
|---|--------------|-------|
| Operating lease rentals                       | <b>252</b>   | 249   |
| Repairs and maintenance                       | <b>136</b>   | 129   |
| Communications and data processing            | <b>467</b>   | 449   |
| Advertising                                   | <b>207</b>   | 205   |
| Professional fees                             | <b>216</b>   | 222   |
| Provisions for customer remediation (note 40) | <b>150</b>   | 112   |
| Other   | <b>543</b>   | 589   |
|   | <b>1,971</b> | 1,955 |
| Depreciation                                  | <b>639</b>   | 638   |
| Impairment charges:                           |              |       |
| Goodwill (note 25)                            | <b>6</b>     |       |
| <hr/>   |              |       |
| Total operating expenses                      | <b>5,471</b> | 5,297 |
| <hr/>   |              |       |

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**10 Operating expenses** (continued)

The average number of persons on a headcount basis employed by the Group during the year was as follows:

|          | 2005          | 2004          |
|----------|---------------|---------------|
| UK       | 77,620        | 79,581        |
| Overseas | 1,974         | 3,372         |
|          | <b>79,594</b> | <b>82,953</b> |

During the year the auditors earned the following fees:

|                                    | 2005<br>£m  | 2004<br>£m |
|------------------------------------|-------------|------------|
| Statutory audit                    | 8.1         | 5.5        |
| Other audit related fees:          |             |            |
| Audit related regulatory reporting | 0.8         | 0.9        |
| Further assurance services         | 1.5         | 6.4        |
| Total other audit related fees     | 2.3         | 7.3        |
| Audit and audit related fees       | <b>10.4</b> | 12.8       |
| Tax advisory                       | 0.6         | 0.8        |
| Other non-audit fees               |             |            |
| Due diligence                      | 0.3         | 0.9        |
| Other                              | 0.5         | 0.3        |
| Total other non-audit fees         | 0.8         | 1.2        |
| Total fees                         | <b>11.8</b> | 14.8       |

The auditors' remuneration for the holding company was £57,000 (2004: £51,500).

During the year the auditors also earned fees of £0.3 million (2004: £0.3 million) in respect of the audit of pension schemes and unconsolidated open ended investment companies managed by the Group.

Included in Other audited related fees are the costs of advice provided in relation to the requirements of the Sarbanes-Oxley Act together with costs in relation to the Group's Form 20-F filing.

It is the Group's policy to use the auditors on assignments in cases where their knowledge of the Group means that it is neither efficient nor cost effective to employ another firm of accountants. Such assignments typically relate to the provision of advice on tax issues, assistance in transactions involving the acquisition and disposal of businesses and accounting advice. The auditors are not permitted to provide management consultancy services to the Group.

The Group has procedures that are designed to ensure auditor independence, including that fees for audit and non-audit services are approved in advance. The audit committee has established de minimis fee limits for particular detailed types of service and has approved in advance all non-audit assignments where the fee falls below the relevant limit. All statutory audit work as well as non-audit assignments where the fee is expected to exceed the relevant limit are subject to individual pre-approval by the audit committee. On a quarterly basis, the audit committee receives a report detailing all pre-approved services and amounts paid to the auditors for such pre-approved services.

**11 Impairment losses on loans and advances**

|                              | 2005<br>£m | 2004<br>£m |
|------------------------------|------------|------------|
| Specific bad debt provisions | 953        | 953        |

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|   |              |      |
|---|--------------|------|
| General bad debt provisions                       |              | (87) |
| Impairment losses on loans and advances (note 20) | <b>1,302</b> | 866  |
| Other credit risk provisions (note 40)            | <b>(3)</b>   |      |
|   | <b>1,299</b> | 866  |

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**12 Profit (loss) on sale and closure of businesses**

|   | 2005<br>£m | 2004<br>£m  |
|---|------------|-------------|
| Net profit (loss) on disposal of businesses                               | 74         | (21)        |
| Adjustment to consideration received in respect of prior period disposals | (4)        |             |
| Provision for costs in respect of the closure of businesses               | (20)       |             |
|   | <b>50</b>  | <b>(21)</b> |

The net profit on the disposal of businesses in 2005 principally relates to the sale of the Goldfish credit card business. During the year ended 31 December 2004 the Group completed the sales of its principal businesses in Colombia and substantially all of the businesses of the branches of Lloyds TSB Bank plc in Argentina, Panama, Guatemala and Honduras.

The businesses sold in 2004 and 2005 were not material to the Group, and consequently they have not been treated as discontinued operations.

**13 Taxation****a Analysis of charge for the year**

|                                       | 2005<br>£m   | 2004<br>£m   |
|---------------------------------------|--------------|--------------|
| UK corporation tax:                   |              |              |
| Current tax on profits for the year   | 862          | 759          |
| Adjustments in respect of prior years | (20)         | (69)         |
|                                       | <b>842</b>   | <b>690</b>   |
| Double taxation relief                | (138)        | (57)         |
|                                       | <b>704</b>   | <b>633</b>   |
| Foreign tax:                          |              |              |
| Current tax on profit for the year    | 78           | 118          |
| Adjustments in respect of prior years | (8)          | (2)          |
|                                       | <b>70</b>    | <b>116</b>   |
| Current tax charge                    | 774          | 749          |
| Deferred tax (note 39)                | 491          | 269          |
|                                       | <b>1,265</b> | <b>1,018</b> |

The charge for tax on the profit for the year is based on a UK corporation tax rate of 30 per cent (2004: 30 per cent).

The Group, as a proxy for policyholders in the UK, is required to record taxes on investment income and gains each year. Accordingly, the tax attributable to UK life insurance policyholder earnings is included in income tax expense. The tax expense attributable to policyholder earnings was £298 million (2004: £36 million), including a prior year tax credit of £25 million (2004: £6 million).

**b Factors affecting the tax charge for the year**

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A reconciliation of the charge that would result from applying the standard UK corporation tax rate to profit before tax to the tax charge for the year is given below:

|   | <b>2005</b>  | 2004      |
|---|--------------|-----------|
|   | <b>£m</b>    | <b>£m</b> |
| Profit before tax                                       | <b>3,820</b> | 3,477     |
| Tax charge thereon at UK corporation tax rate of 30%    | <b>1,146</b> | 1,043     |
| Factors affecting charge:                               |              |           |
| Disallowed and non-taxable items                        | (47)         | (32)      |
| Overseas tax rate differences                           | (1)          | (14)      |
| Net tax effect of disposals and unrealised gains        | (59)         | (2)       |
| Tax deductible coupons on non-equity minority interests |              | (12)      |
| Policyholder tax and Open Ended Investment Companies    | 223          | 33        |
| Other items   | 3            | 2         |
| Tax on profit on ordinary activities                    | <b>1,265</b> | 1,018     |
| Effective rate  | <b>33.1%</b> | 29.3%     |

The effective tax rate of the Group excluding the gross policyholder tax charge and Open Ended Investment Company interests from profit before tax and the tax charge was 27.0 per cent (2004: 28.3 per cent).

#### 14 Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year, which has been calculated after deducting 5 million (2004: 6 million) ordinary shares representing the Group's holdings of own shares in respect of employee share schemes.

|   | 2005           | 2004    |
|---|----------------|---------|
| Profit attributable to equity shareholders          | <b>£2,493m</b> | £2,392m |
| Weighted average number of ordinary shares in issue | <b>5,595m</b>  | 5,590m  |
| Basic earnings per share                            | <b>44.6p</b>   | 42.8p   |

For the calculation of diluted earnings per share the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The Company has dilutive potential ordinary shares in respect of share options granted to employees. The number of shares that could have been acquired at market price (determined as the average annual share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options is determined; the residual bonus shares are added to the weighted average number of ordinary shares in issue, but no adjustment is made to the profit attributable to equity shareholders.

|   | 2005           | 2004    |
|---|----------------|---------|
| Profit attributable to equity shareholders                                | <b>£2,493m</b> | £2,392m |
| Weighted average number of ordinary shares in issue                       | <b>5,595m</b>  | 5,590m  |
| Adjustment for share options  | <b>44m</b>     | 35m     |
| Weighted average number of ordinary shares for diluted earnings per share | <b>5,639m</b>  | 5,625m  |

|                            |              |       |
|----------------------------|--------------|-------|
| Diluted earnings per share | <b>44.2p</b> | 42.5p |
|----------------------------|--------------|-------|

The weighted average number of anti-dilutive share options excluded from the calculation of diluted earnings per share was 17 million at 31 December 2005 (2004: 39 million).

#### 15 Treasury bills and other eligible bills

Up to 31 December 2004 (prior to the implementation of IAS 32 and IAS 39 on 1 January 2005) treasury bills and other eligible bills were shown separately on the balance sheet. This balance sheet caption comprised both investment securities and other securities. Investment securities were those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. At 31 December 2005, treasury bills and other eligible bills are categorised as either trading securities and other financial assets at fair value through profit or loss (note 16) or available-for-sale financial assets (note 23).

Details of the balance sheet carrying value of the treasury bills and other eligible bills held at 31 December 2004 were as follows:

|  | £m |
|--|----|
| Investment securities:   |    |
| Treasury bills and similar securities                                  | 75 |
| Other eligible bills   | 13 |
|  | 88 |
| Other securities:  |    |
| Treasury bills and similar securities                                  | 4  |
| Balance sheet carrying value – treasury bills and other eligible bills | 92 |

Geographical analysis by issuer:

|               |    |
|---------------|----|
| Latin America | 18 |
|---------------|----|

|       |    |
|-------|----|
| Other | 74 |
|       | 92 |

**16 Trading securities and other financial assets at fair value through profit or loss**

From 1 January 2005 (upon the implementation of IAS 32 and IAS 39), the Group is required to disclose its trading securities and other financial assets at fair value through profit or loss separately on the face of the balance sheet.

Details of the balance sheet carrying value of these assets held at 31 December 2005 are:

|   | £m            |
|---|---------------|
| Trading securities  | 5,442         |
| Other financial assets at fair value through profit or loss | 54,932        |
|   | <b>60,374</b> |

These assets are comprised as follows:

|   | Trading securities<br>£m | Other financial<br>assets at fair<br>value through<br>profit or loss<br>£m |
|---|--------------------------|--|
| Loans and advances to banks                       | 5                        | 5  |
| Loans and advances to customers                   | 161                      | 445  |
| Debt securities:                                  |                          |  |
| Government securities                             | 535                      | 10,638   |
| Other public sector securities                    | 35                       | 84   |
| Bank and building society certificates of deposit |                          | 898  |
| Corporate debt securities                         | 4,667                    | 4,214  |
| Mortgage backed securities                        | 39                       | 197  |
| Other asset backed securities                     |                          | 691  |
| Other debt securities                             |                          | 4,255  |
|   | 5,276                    | 20,977   |
| Equity shares:                                    |                          |  |
| Listed  |                          | 27,497   |
| Unlisted  |                          | 6,008  |
|   |                          | <b>33,505</b>  |
|   | <b>5,442</b>             | <b>54,932</b>  |

See notes 15, 21 and 22 for details of investments held at 31 December 2004.



**17 Derivative financial instruments and other trading liabilities**

The principal derivatives used by the Group are interest rate and exchange rate contracts; particular attention is paid to the liquidity of the markets and products in which the Group trades to ensure that there are no undue concentrations of activity and risk.

Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal amount at a specific date in the future. An interest rate option gives the buyer, on payment of a premium, the right, but not the obligation, to fix the rate of interest on a future loan or deposit, for a specified period and commencing on a specified future date.

Exchange rate related contracts include forward foreign exchange contracts, currency swaps and options. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. A currency option gives the buyer, on payment of a premium, the right, but not the obligation, to sell specified amounts of currency at agreed rates of exchange on or before a specified future date.

Equity derivatives are also used by the Group as part of its equity based retail product activity to eliminate the Group's exposure to fluctuations in various international stock exchange indices. Index-linked equity options are purchased which give the Group the right, but not the obligation, to buy or sell a specified amount of equities, or basket of equities in the form of published indices on or before a specified future date.

The principal amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate.

| 31 December 2005                                     | Contract/notional<br>amount<br>£m | Fair value<br>assets<br>£m | Fair value<br>liabilities<br>£m |
|--|-----------------------------------|----------------------------|---------------------------------|
| <b>Trading</b>                                       |                                   |                            |                                 |
| Exchange rate contracts:                             |                                   |                            |                                 |
| Spot, forwards and futures                           | 145,591                           | 1,515                      | 1,345                           |
| Currency swaps                                       | 12,306                            | 267                        | 204                             |
| Options purchased                                    | 3,623                             | 58                         |                                 |
| Options written                                      | 3,892                             |                            | 45                              |
|  | 165,412                           | 1,840                      | 1,594                           |
| Interest rate contracts:                             |                                   |                            |                                 |
| Interest rate swaps                                  | 288,725                           | 2,814                      | 3,860                           |
| Forward rate agreements                              | 50,006                            | 16                         | 20                              |
| Options purchased                                    | 12,679                            | 108                        |                                 |
| Options written                                      | 8,812                             |                            | 85                              |
| Futures  | 29,358                            |                            |                                 |
|  | 389,580                           | 2,938                      | 3,965                           |
| Equity and other contracts                           | 5,349                             | 610                        | 84                              |
| Total derivative assets/liabilities held for trading |                                   | 5,388                      | 5,643                           |
| <b>Hedging</b>                                       |                                   |                            |                                 |
| <i>Derivatives designated as fair value hedges:</i>  |                                   |                            |                                 |
| Cross currency interest rate swaps                   | 69                                | 12                         |                                 |
| Interest rate swaps (including swap options)         | 39,499                            | 473                        |                                 |