LLOYDS TSB GROUP PLC
Form 20-F
June 29, 2005

As filed with the Securities and Exchange Commission on 29 June 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g)

OF THE SECURITIES EXCHANGE ACT OF 1934

OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended 31 December 2004

OR

o TRANSITION 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 2004 was:

Ordinary shares, nominal value 25 pence each, as of 31 December 2004...5,596,397,111

Limited voting shares, nominal value 25 pence each, as of 31 December 2004... 78,947,368

Preference shares, nominal value 25 pence each, as of 31 December 2004... 400

Preference shares, nominal value 25 cents each, as of 31 December 2004..... 0

Preference shares, nominal value 25 euro cents each, as of 31 December 2004..... 0

Preference shares, nominal value Japanese ¥25 each, as of 31 December 2004... 0

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 x No o

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 o Item 18 x

TABLE OF CONTENTS

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$ c $ 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 a 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 2004, which was $1.9160 = £1.00. The Noon Buying Rate on 31 December 2004 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 accounting principles generally accepted in the UK.

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 2004 total Lloyds TSB Group assets were £279,843 million and Lloyds TSB Group had some 70,000 employees. Lloyds TSB Group plc s market capitalisation at that date was some £26,500 million. The profit on ordinary activities before tax for the 12 months to 31 December 2004 was £3,493 million and the risk asset ratios as at that date were 10.0 per cent for total capital and 8.9 per cent for tier 1 capital.

The operations of Lloyds TSB Group in the UK were conducted through approximately 2,200 branches of Lloyds TSB Bank, Lloyds TSB Scotland plc and Cheltenham & Gloucester plc at the end of December 2004. 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 .

The following table shows the profit before tax of Lloyds TSB Group s UK Operations and its International Operations in each of the last three years. The profit before tax for the year ended 31 December 2003 includes the profit on the sale of a number of overseas businesses, in particular The National Bank of New Zealand.

	2004	2003	2002
	£m	£m	£m
UK Operations	**3,295**	2,810	2,122
International Operations	**198**	1,538	496
Profit before tax	**3,493**	4,348	2,618

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 three fiscal years. In order to provide a clearer representation of the underlying performance, the results of the Insurance and Investments segment include investment earnings calculated using longer-term rates of return and annual management charges based on unsmoothed fund values. Management separately analyse the difference between these normalised earnings and the actual return (the investment variance) together with the impact of changes in the economic assumptions used in the embedded value calculation.

	2004	2003	2002
	£m	£m	£m
UK Retail Banking	**1,651**	1,471	1,548
Insurance and Investments	**773**	565	638
Wholesale and International Banking continuing operations	**1,272**	1,038	1,005
Central group items	**(333)**	(12)	36
	3,363	3,062	3,227
Changes in economic assumptions	**(2)**	(22)	55
Investment variance	**147**	125	(943)
Loss on sale of businesses in 2004	**(15)**		
Discontinued operations in 2003 and 2002		1,183	279
Profit before tax	**3,493**	4,348	2,618

Restated, as explained on page 26.

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.

SELECTED CONSOLIDATED FINANCIAL DATA

The financial information set out in the table 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 years 2000 and 2001 were audited by PricewaterhouseCoopers, independent accountants; the financial statements for each of the years 2002 to 2004 have been audited by their successor firm PricewaterhouseCoopers LLP, independent accountants.

The financial statements have been prepared in accordance with UK GAAP, which differs in certain significant respects from US GAAP. A discussion of such differences and a reconciliation of certain UK GAAP amounts to US GAAP is included in note 50 to the financial statements.

	2004	2003	2002	2001	2000
Profit and loss account data for the year ended 31 December (£m)1					
Net interest income	**4,920**	5,255	5,171	4,922	4,587
Other finance income	**39**	34	165	307	424
Other income	**4,608**	4,619	3,551	3,659	3,760
Trading surplus	**4,650**	4,735	3,974	4,119	4,503
Provisions for bad and doubtful debts	**(866)**	(950)	(1,029)	(747)	(541)
Profit on ordinary activities before tax	**3,493**	4,348	2,618	3,167	3,791
Profit on ordinary activities after tax	**2,489**	3,323	1,852	2,290	2,707
Profit for the year attributable to shareholders	**2,421**	3,254	1,790	2,233	2,658
Dividends	**1,914**	1,911	1,908	1,872	1,683
Balance sheet data at 31 December (£m)1					
Called-up share capital	**1,419**	1,418	1,416	1,411	1,396
Shareholders funds (equity and non-equity)	**9,977**	9,624	7,943	10,326	11,877
Customer accounts	**122,062**	116,496	116,334	109,116	101,989
Undated subordinated loan capital	**5,852**	5,959	5,496	4,102	3,391
Dated subordinated loan capital	**4,400**	4,495	4,672	4,006	4,119
Loans and advances to customers	**154,240**	135,251	134,474	122,935	114,432
Assets2	**225,079**	201,934	207,343	189,317	169,495
Total assets	**279,843**	252,012	252,561	235,501	220,383
Share information1					
Basic earnings per ordinary share	**43.3p**	58.3p	32.1p	40.4p	48.4p
Diluted earnings per ordinary share	**43.0p**	58.1p	32.0p	40.0p	47.9p
Net asset value per ordinary share	**176p**	170p	140p	183p	213p
Dividends per ordinary share3	**34.2p**	34.2p	34.2p	33.7p	30.6p
Equivalent cents per share3, 4	**63.7c**	59.7c	54.1c	49.3c	44.2c
Market price (year-end)	**473p**	448p	446p	746p	708p
Number of shareholders (thousands)	**953**	974	973	981	1,026
Number of ordinary shares in issue (millions)7	**5,596**	5,594	5,583	5,564	5,507
Financial ratios (%)1, 5					
Dividend payout ratio	**79.1**	58.7	106.6	83.8	63.3
Post-tax return on average shareholders equity	**24.3**	38.5	16.8	18.1	21.2
Post-tax return on average assets	**1.17**	1.57	0.93	1.28	1.68
Post-tax return on average risk-weighted assets	**2.01**	2.63	1.62	2.26	3.08
Average shareholders equity to average assets	**4.7**	4.0	5.4	6.9	7.8
Cost: income ratio6	**51.4**	52.2	55.3	53.7	48.7
Capital ratios (%)1					
Total capital	**10.0**	11.3	9.6	8.8	8.6
Tier 1 capital	**8.9**	9.5	7.7	7.7	7.9

1 Figures for 2002 and earlier years have been restated to reflect the implementation of UITF 37, Purchases and sales of own shares, UITF 38, Accounting for ESOP trusts, FRS 18, Accounting Policies, FRS 17, Retirement Benefits, FRS 19, Deferred Tax, UITF 33 Obligations in Capital Instruments, and detailed

guidance from the Association of British Insurers for best practice in the preparation of results using the achieved profits method of accounting and other minor adjustments.

2 Assets exclude long-term assurance assets attributable to policyholders.

3 Annual dividends comprise both interim and final dividend payments. Final dividends (which are always paid in the following year) are included in the year to which they relate rather than in the year in which they are paid.

4 Translated into US dollars at the Noon Buying Rate on the date each payment was made, except for the 2003 final dividend which has been translated at the Noon Buying Rate on 31 December 2003.

5 Averages are calculated on a monthly basis from the consolidated financial data of Lloyds TSB Group.

6 The cost: income ratio is calculated as total operating expenses as a percentage of total income.

7 This figure excludes 79 million limited voting ordinary shares.

SELECTED US GAAP FINANCIAL DATA	2004	2003	2002	2001	2000
Income statement data for the year ended 31 December (£m)(1)					
Total revenues, net of interest expense	**16,668**	14,139	10,498	9,335	10,380
Policyholder benefits and claims expense	**(4,473)**	(3,036)	(1,565)	(2,228)	(1,735)
Provision for bad and doubtful debts	**(866)**	(950)	(1,029)	(747)	(541)
Income before tax	**3,214**	4,220	2,378	2,221	2,759
Net income	**1,508**	3,231	1,753	1,635	1,989
Dividends	**1,913**	1,908	1,903	1,738	1,522
Balance sheet data at 31 December (£m)					
Shareholders equity	**11,458**	11,892	10,164	13,505	13,682
Deposits	**159,546**	140,451	141,777	133,419	117,473
Loans, net of provisions	**152,428**	134,043	134,202	122,485	110,788
Total assets	**281,598**	251,158	254,352	243,187	225,734
Share information (pence per ordinary share)					
Basic earnings	**27.0**	57.9	31.5	29.5	36.2
Diluted earnings	**26.8**	57.7	31.3	29.2	35.9
Net asset value	**202**	210	180	240	245
Dividends	**34.2**	34.2	34.2	31.5	27.8
Financial ratios (%)(2)					
Dividend payout ratio	**126.9**	59.1	108.6	106.4	76.5
Post-tax return on average shareholders equity	**12.9**	29.3	14.8	12.0	14.8
Post-tax return on average assets	**0.65**	1.29	0.73	0.72	1.00
Average shareholders equity to average assets	**4.4**	4.4	4.8	5.8	6.6

(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.

4

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:

	2005 May	2005 April	2005 March	2005 February	2005 January	2004 December
US dollars per pound sterling:						
High	1.90	1.92	1.93	1.92	1.91	1.95
Low	1.82	1.87	1.87	1.86	1.86	1.91

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

	2004	2003	2002	2001	2000
US dollars per pound sterling:					
Average	1.84	1.64	1.51	1.44	1.52

On 21 June 2005, the latest practicable date, the US dollar Noon Buying Rate was $1.824 = £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 18th century when the banking partnership of Taylor and Lloyds was established in the UK. The early years of the 20th century were marked by many acquisitions and mergers, significantly increasing the number of banking offices in the UK. Lloyds TSB Bank expanded further in the late 1980 s by the creation of the insurance-led group of Lloyds Abbey Life following the merger of five Lloyds TSB Bank businesses and Abbey Life Group plc, 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 2000, Lloyds TSB Group acquired Scottish Widows, for a total consideration of £5,947 million. This transaction positioned Lloyds TSB Group as one of the leading suppliers of long-term savings and protection products in the UK.

During 2003 and 2004, the Lloyds TSB Group 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. The sale of Lloyds TSB Group s French fund management business, The National Bank of New Zealand and substantially all of the Group s Brazilian businesses in 2003 were followed in 2004 by the completion of the disposal of its businesses in Guatemala, Honduras and Panama and by the disposal of its businesses in Argentina and Colombia. 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 and considers that one of its greatest competitive advantages is the ability of its people to adapt to rapid and far reaching change. 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. On 12 January 2004 Philip Hampton, group finance director, left the board and was replaced by Helen Weir, formerly group finance director of Kingfisher, who joined the board on 26 April 2004. In the intervening period, the finance director s duties were carried out by Mike Fairey, deputy group chief executive. Steve Targett, group executive director, Wholesale and International Banking, left the board on 30 April 2004; he was replaced by Truett Tate who filled the role from the date of Mr Targett s departure and who was appointed to the board as group executive director, Wholesale and International Banking on 1 August 2004. 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.

Four non-executive directors have left the board: the Earl of Selborne (on 21 May 2004), Sir Tom McKillop (on 31 December 2004), Dr Chris Gibson-Smith and David Pritchard (both on 5 May 2005). Sir Julian Horn-Smith joined the board, as a non-executive director, on 1 January 2005.

On 1 February 2004, Frans Hijkoop joined the Lloyds TSB Group as director of Group Human Resources and became a member of the group executive committee but did not become a member of the board. On 1 March 2004, Carol Sergeant, formerly managing director, Regulatory Process and Risks Directorate for the UK Financial Services Authority, joined the Lloyds TSB Group as chief risk director and also became a member of the group executive committee but did not become a member of the board.

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.

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. The acquisition of Scottish Widows in March 2000 has greatly enhanced Lloyds TSB Group s market position in the life assurance and investment markets. In the recent past weak share prices have depressed the long-term savings markets, however in the longer term they are expected to exhibit strong demand growth driven primarily by demographic factors. Within Asset Finance, Lloyds TSB Group has acquired Chartered Trust, First National Vehicle Holdings, Abbey National Vehicle Finance and the Dutton-Forshaw Group to enhance its leading positions in the UK point of sale motor finance and contract hire markets. Lloyds TSB Group has recently divested businesses in New Zealand and Latin America which were markets in which Lloyds TSB Group did not expect to be able to build and sustain competitive advantage.

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, the only 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, 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.

Lloyds TSB Group remains alert for opportunities to grow through acquisitions that complement its organic strategies and help provide new opportunities for profitable growth, both in the UK and overseas. Lloyds TSB Group s strategy is to focus initially on improving performance in its core markets and by doing so build an advantaged platform for subsequent expansion into new markets.

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

UK Retail Banking provides banking, financial services, mortgages and private banking to some 15 million personal customers using multi channel distribution capabilities.

Branches. Lloyds TSB Group provides wide-reaching geographic branch coverage in England, Scotland and Wales, with some 2,200 branches of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester as at the end of 2004.

Internet banking. Internet banking provides online banking facilities for personal customers. Some 3 million customers have registered to use Lloyds TSB Group s internet banking services.

Telephone banking. Telephone banking continues to grow and Lloyds TSB Group provides, in terms of customer numbers, one of the largest telephony services in Europe. At the end of 2004, some 4.8 million customers had registered to use the services of PhoneBank and the automated voice response service PhoneBank Express. Lloyds TSB Group s telephone banking contact centres handled some 62 million calls during 2004.

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 2004, 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 50,000 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 had a 12.7 per cent share of outstanding card balances at 31 December 2004.

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 the third largest residential mortgage lender in the UK on the basis of outstanding balances, with mortgages outstanding at 31 December 2004 of £80,065 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 30 offices throughout the UK. In addition to asset management, these include tax and estate planning, executor and trustee services, deposit taking and lending, insurance and 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, unit trust 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 long-term business fund is divided into With-Profits and Non-Participating 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-Participating 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.

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 corporate 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

2004 has seen a further increase in corporate activity with the tighter integration of the businesses within the Wholesale Bank.

Corporate Markets combining the respective strengths of Corporate Banking, Structured Finance and Financial Markets, plays an integral role in leveraging and expanding the customer franchise and building deep, long-lasting relationships. Corporate Banking manages the core 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 capital and expertise in a broad range of financial solutions. The relationship managers act as a conduit to partners in the Wholesale Bank and other parts of the Group. Structured Finance comprises the private equity and leveraged debt businesses and other transactional lending businesses of the Wholesale Bank. Structured Finance executes transactions within the existing corporate franchise as well as building an avenue for new to bank relationships. Financial Markets is a leading participant in the sterling money market. It is also active in currency money markets, foreign exchange markets and in certain derivatives markets, primarily to meet the needs of customers. It also plays a central role in the funding, cash and liquidity management of Lloyds TSB Group.

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 customers. Specialist personal lending, store credit and the Dutton-Forshaw motor dealership group complete this group of businesses.

Business Banking. Relationships with some 574,000 small businesses are managed by around 1,700 dedicated business managers based in over 500 locations throughout the UK supported by nearly 2,000 business customer advisers in branches. Lloyds TSB Group is one of the leading banks for new business start-ups with nearly a quarter of new businesses opening an account with Lloyds TSB. 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 reshape its international network in 2004 as the sales of its businesses in Argentina, Colombia, Guatemala, Panama and Honduras were completed during the year.

Europe. Lloyds TSB Group has private banking operations for wealthy individuals outside their country of residence. The business is conducted through branches of Lloyds TSB Bank located in Switzerland, Luxembourg, Monaco and Gibraltar. There are also personal and corporate banking operations in Belgium, The Netherlands and Spain.

Offshore banking. Lloyds TSB Group s offshore banking operations comprise offices in the UK, the Channel Islands, the Isle of Man and overseas representative offices in the Middle East, 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.

The Americas. Lloyds TSB Group continues to have offices in Ecuador, Paraguay and Uruguay which provide mainly corporate banking services. In addition, Lloyds TSB Group has private banking and investment operations in the US.

Middle East and Asia. There are banking operations in Hong Kong, Singapore, Tokyo, Malaysia and Dubai.

Recent developments

Lloyds TSB Group issued a trading statement on 20 June 2005, which made the following comments:

On a comparable basis under International Financial Reporting Standards (IFRS), excluding the impact of prospective accounting changes relating to the implementation of IFRS, Lloyds TSB expects to deliver a satisfactory trading performance for the first half of 2005 and continues to deliver good earnings growth, demonstrating further progress in its key strategic priorities.

The Retail Bank has continued to make progress in quality customer recruitment and profitable franchise development, and is expected to achieve satisfactory levels of customer lending and deposit balance growth during the half-year, against a backdrop of slowing consumer spending. The rate of consumer lending growth in the first half of 2005 is however expected to be slightly lower than the double digit growth rates experienced in recent years.

Scottish Widows has continued to benefit from its focus on product and capital efficiency. The launch, in the second half of 2004, of a new range of products more tailored to the branch network distribution channel has delivered an uplift in unit trust/OEIC sales during the first quarter of 2005. In addition, strong progress continues to be made in the distribution of life, pensions and long-term savings products through the Independent Financial Adviser distribution channel.

In Wholesale and International Banking, strong progress continues in developing and deepening our franchises. In Business Banking and Corporate Markets, in particular, we are registering meaningful gains which reflect both our emphasis on product and relationship cross-sell, and new customer acquisition. All main businesses within the division continue to perform well and we are achieving good levels of profitable new business.

The Group s strong cost performance in recent years has continued into the first half of 2005 and we have made further improvements in processing quality. The Group continues to expect to deliver revenue growth in excess of cost growth, on an IFRS comparable basis, in the first half of 2005.

Our focus on lending to existing customers, in a slowing consumer environment, has resulted in overall asset quality remaining satisfactory. On an IFRS comparable basis, the Group s impairment charge for loan losses from its continuing operations, as an annualised percentage of average lending, is expected to be broadly consistent with the provisions charge in the first half of 2004. A higher charge in Retail Banking, reflecting an increase in the number of customers experiencing repayment difficulties, is expected to be offset by a lower charge in the Group s corporate lending portfolios.

Current indications remain that the overall impact of the full implementation of IFRS, excluding the volatility introduced by the requirements of IFRS and FRS 27, will be to reduce the Group s full year reported earnings per share, compared with those that would have been reported under UK GAAP, by approximately 6 per cent. Profit before tax (before volatility) is expected to be approximately 8 per cent lower. This likely reduction in earnings in 2005 is almost entirely due to changes in the timing of income and expense recognition in the Group s financial statements, in particular with regard to the application of effective interest rates, the reclassification of certain securities from equity to debt, and the impact of discounting on levels of loan loss impairment. The Group will endeavour to ensure that comparable underlying business performance and trends, which exclude the impact of prospective accounting changes relating to the implementation of IFRS, are clearly identified on an ongoing basis.

Eric Daniels, Group Chief Executive, said We are continuing to make progress against our objective to deliver sustained earnings growth, despite signs of a slowing consumer environment in the UK, and the Group is on track to deliver a satisfactory trading performance for the first half of 2005.

Properties

As at 31 December 2004, Lloyds TSB Group occupied 3,394 properties in the UK. Of these, 699 were held as freeholds, 78 as long-term leaseholds and 2,617 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 general insurance 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.

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 assurers 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.

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 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, the UK financial services industry is characterised by recent government intervention and regulation. This partly emanates from Europe as part of the Financial Services Action Plan or in the shape of EU social legislation. Many of the reviews instigated by the UK government into the financial services sector have been against a backdrop of increased consumerism, driven by support for open competition and a fair deal for the consumer.

Lloyds TSB Group has always supported the principle of competition and agrees with the importance of building consumer confidence in financial services. Lloyds TSB Group has concerns about the introduction of price controls, which would be a barrier to entry and believes that voluntary codes, rather than statutory regulation, are in the best interests of consumers and competition.

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 UK GAAP, which varies in certain significant respects from US GAAP. A discussion of such differences and a reconciliation of certain UK GAAP amounts to US GAAP is included in note 50 to the Consolidated Financial Statements.

TABLE OF CONTENTS

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. In 2004, 94 per cent 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.

During 2004 the UK economy benefited from global economic growth approaching 5 per cent. This stimulated a recovery in the manufacturing sector and strengthened the corporate sector, as demand has boosted profit growth and more stable share prices have encouraged business investment. The consumer sector has remained strong as house prices continued to increase rapidly in the first half of the year, although some levelling off in house prices was experienced towards the end of the year.

Growth is expected to slow during 2005 as a result of the impact of interest rate increases in 2004. The high level of consumer debt has made consumers very responsive to interest rate changes, with the burden of debt repayments now above the long-term average. Although the growth in house prices is expected to slow in 2005, consumer confidence should not be significantly affected; a gradual economic slowdown usually implies little change in unemployment, which is a major driver of confidence.

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 personal loans and credit card balances; Insurance and Investments, as a result of increased weighted sales, particularly from Independent Financial Advisers; and Wholesale and International Banking, which has seen increased volumes in Asset Finance and Corporate products, where the creation of an integrated regional sales structure has already started to generate positive results.

Lloyds TSB Group s net interest margin declined during 2004, reflecting the impact of changes in business mix and lower margins in the Group s credit card, personal lending and mortgage portfolios as a result of competitive pressures. The bad debt charge for 2004 was lower than in 2003; this resulted from a lower charge in Wholesale and International Banking, primarily within Corporate as a result of improving economic conditions, and a higher charge in UK Retail Banking, reflecting volume related growth in personal loans and credit card lending.

Critical accounting policies

Introduction

The results of Lloyds TSB Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. The accounting policies used in the preparation of the financial statements are set out in note 1 to the financial statements. In preparing the financial statements, the directors are required to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. Where UK GAAP allows a choice of policy, Financial Reporting Standard 18 Accounting Policies requires Lloyds TSB Group to adopt those policies judged to be most appropriate to its particular circumstances for the purpose of giving a true and fair view.

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 below.

Provisions for bad and doubtful debts

In circumstances where there is significant doubt over the recoverability of specific loans and advances, provisions are made to reduce the carrying value of those advances to their expected ultimate net realisable value; at 31 December 2004, the Lloyds TSB Group held specific provisions totalling £1,383 million. 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, specific provisions are calculated using formulae which take into account factors such as the length of time that the customer s account has been delinquent, historic loss rates and the value of any collateral held. 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 the Lloyds TSB Group s other lending portfolios, provisions are calculated on a case-by-case basis having regard 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 Lloyds TSB Group also maintains a general provision to cover latent bad and doubtful debts which are present in any portfolio of advances but which have not been specifically identified; at 31 December 2004, the general provision amounted to £280 million. The calculation of the general provision requires a significant amount of judgement to assess the level of losses inherent in the portfolio and is based upon factors such as the level of watchlist or potential problem debt, the propensity for such debt to become impaired and historic loss rates. The general provision is allocated to business units which are responsible for reviewing the balance on a regular basis to ensure that it remains appropriate in prevailing economic conditions and in the light of the perceived level of credit risk within their lending portfolios.

Customer remediation provisions

The Lloyds TSB 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.

Goodwill impairment

Lloyds TSB Group reviews the goodwill arising on the acquisition of subsidiary undertakings when events or changes in economic circumstances indicate that impairment may have taken place and at the end of the first full year after an acquisition. In addition, since the goodwill arising on the acquisition of Scottish Widows is considered to have an indefinite useful life, because of the strength of the brand and the position of the business as one of the leading providers of life, pensions, unit trust and fund management products, and is therefore not amortised, the Lloyds TSB Group is required under UK GAAP to perform an annual review to determine whether an impairment has occurred.

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 approximating to the estimated weighted average cost of capital of the business. If the present value of the projected cash flows were to be materially less than the carrying value of the underlying net assets and related goodwill an impairment would have occurred and a charge would be made to the profit and loss account. This calculation requires the exercise of significant judgement by management; if the estimates made prove to be incorrect or changes in Scottish Widows performance affect the amount and timing of future cash flows, the goodwill may become impaired in future periods.

Embedded value

Lloyds TSB Group accounts for the value of the shareholder s interest in the long-term assurance business using the embedded value basis of accounting. The embedded value is comprised of the net tangible assets of the life assurance subsidiaries and the present value of the projected future surplus arising on the in-force business, which is calculated by projecting these surpluses and other net cash flows attributable to the shareholder arising from business written by the balance sheet date and discounting the result at a rate which reflects the shareholder s overall risk premium.

Future surpluses will depend on experience in a number of areas such as investment returns, lapse rates, mortality and investment expenses. Surpluses are projected by making assumptions about future experience, having regard to both actual experience and forecast long-term economic trends. Changes to these assumptions may cause the present value of future surpluses to differ from those assumed at the balance sheet date and could significantly affect the value attributed to the in-force business. In note 29 to the financial statements the effect of illustrative changes in the principal economic assumptions upon the embedded value included in the balance sheet and new business income is set out.

The value of the in-force business could also be affected by unpredicted changes in investment market levels and other in-period variances between expected and actual experience. Investment market levels principally affect annual management charges and other fees levied on policyholders, which are reflected in the profit and loss account using unsmoothed fund values. In addition, to the extent that actual experience is different from that assumed, for example with respect to mortality or persistency, the effect will be recognised in the profit and loss account for the period. The effect of changes in the underlying assumptions and variations between actual and assumed experience on the results of the current and prior periods are disclosed in note 29 in the financial statements.

Results of operations 2004 compared with 2003 and 2003 compared with 2002

Summary

	2004	2003	2002
	£m	£m	£m
Net interest income	**4,920**	5,255	5,171
Other finance income	**39**	34	165
Other income	**4,608**	4,619	3,551
Total income	**9,567**	9,908	8,887
Operating expenses	**(4,917)**	(5,173)	(4,913)
Trading surplus	**4,650**	4,735	3,974
General insurance claims	**(224)**	(236)	(229)
Provisions for bad and doubtful debts	**(866)**	(950)	(1,029)
Amounts written off fixed asset investments	**(52)**	(44)	(87)
Operating profit	**3,508**	3,505	2,629
Share of results of joint ventures		(22)	(11)
(Loss) profit on sale of businesses	**(15)**	865	
Profit on ordinary activities before tax	**3,493**	4,348	2,618
Tax on profit on ordinary activities	**(1,004)**	(1,025)	(766)
Profit on ordinary activities after tax	**2,489**	3,323	1,852
Minority interests:			
Equity	**(26)**	(22)	(19)
Non-equity	**(42)**	(47)	(43)
Profit attributable to shareholders	**2,421**	3,254	1,790
Economic profit[1]	**1,525**	2,493	830

1 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 .

2004 compared with 2003

In 2004 the Group s profit before tax was £3,493 million, a decrease of £855 million compared to £4,348 million in 2003. This decrease was attributable to the impact in 2003 of the profit on the sale and trading results of a number of overseas businesses, which contributed £1,183 million. For the same reason, profit attributable to shareholders decreased by £833 million, or 26 per cent, to £2,421 million and earnings per share decreased by 26 per cent to 43.3p. Excluding these discontinued operations from the comparative figures, the profit before tax of £3,493 million in 2004 was up by £328 million, or 10 per cent, from £3,165 million in 2003.

Net interest income of £4,920 million was down £335 million, or 6 per cent, from £5,255 million in 2003. Excluding discontinued operations from the comparative figures for 2003, net interest income was £176 million, or 4 per cent, higher at £4,920 million compared to £4,744 million in 2003. Average interest-earning assets grew by £6,085 million, or 4 per cent, to £178,981 million in 2004 compared to £172,896 million in 2003. However, comparisons of average interest-earning assets are distorted by the effect of the businesses sold in 2003 and by substantial growth, during 2004, in balances of fine margin, but capital efficient, reverse repurchase agreements held for liquidity purposes. Excluding discontinued operations and balances held under reverse repurchase agreements, average interest-earning assets grew by £12,058 million, or 8 per cent, to £170,225 million in 2004 compared to £158,167 million in 2003, adding £351 million to net interest income. This growth reflected substantially higher volumes in mortgages, personal lending and card balances, asset finance and corporate lending. The net interest margin, again excluding discontinued operations and balances held under reverse repurchase agreements, fell by 11 basis points to 2.89 per cent in 2004 compared to 3.00 per cent in 2003, reducing net interest income by £173 million, largely reflecting competitive pressures leading to keener pricing in a number of areas. Exchange rate movements, excluding discontinued operations, accounted for the remaining reduction of £2 million in net interest income.

Other finance income of £39 million was £5 million higher than in 2003. A £68 million increase in the expected return on defined benefit pension scheme assets, as a result of an improvement in market levels at the end of 2003, was largely offset by a £63 million increase in the interest cost of scheme liabilities, reflecting an increase in liability levels over 2003.

Other income of £4,608 million was £11 million lower than in 2003. However, excluding discontinued operations from the comparative figures for 2003, other income was £131 million, or 3 per cent, higher. Fees and commissions receivable, excluding discontinued operations, were £137 million higher, reflecting growth in UK current account fees and card services fees, partly reflecting the acquisition of the Goldfish business at the end of September 2003, and in fee income from company registration, mortgage, unit trust and corporate banking activities. Fees and commissions payable, excluding discontinued operations, were £56 million higher, as a result of growth in the asset finance and card services businesses. Dealing profits, excluding discontinued operations, were £254 million lower, as a result of the non-repetition of the gains made in 2003 on the sale of the Lloyds TSB Group s remaining portfolio of emerging markets debt securities and the closure of certain foreign exchange positions. Income from long-term assurance business, excluding discontinued operations, was £279 million higher as a result of a reduction in the charge in respect of provisions for customer redress and a significant improvement in profitability within the Scottish Widows business.

Operating expenses of £4,917 million were £256 million, or 5 per cent, lower than £5,173 million in 2003. Excluding discontinued operations from the comparative figures, expenses in 2004 were £16 million higher than in 2003. Significant improvements have been made in processing and operational efficiency and the Group has continued to expand its programme of offshoring a number of its processing and back office operations to India. There was an increase of £116 million in staff costs, reflecting the annual pay rise, improved profit related and other incentive payments, especially within the growing corporate banking business, and the impact of the acquisition of the Goldfish business at the end of September 2003. Premises and equipment costs were £5 million higher and communications, advertising and professional fees and other costs were £34 million higher. These increases were, however, largely offset by a £44 million reduction in the depreciation charge, due to a change in mix in the operating lease portfolio and an accelerated charge made in 2003, and a reduction of £100 million in the charge in respect of provisions for customer redress in the Lloyds TSB Group s banking businesses.

General Insurance claims were £12 million lower as a result of relatively low weather-related claims in 2004.

The charge in respect of provisions for bad and doubtful debts was £84 million, or 9 per cent, lower at £866 million compared to £950 million in 2003. Excluding discontinued operations, the charge was £21 million, or 2 per cent, lower at £866 million compared to £887 million in 2003. There was an increase of £79 million within UK Retail Banking, as a result of the acquisition of the Goldfish business and organic growth in personal lending and credit cards, only partly offset by a higher net release in respect of the mortgage portfolio. Within Wholesale and International Banking, however, there was a reduction of £113 million, excluding discontinued operations, as the impact of volume growth in the asset finance operations was more than offset by a reduced charge in respect of corporate banking and the release of £30 million from the general provision that was held in respect of the Lloyds TSB Group s exposures in Argentina.

Amounts written off fixed asset investments of £52 million were £8 million higher than in 2003, as a result of higher volumes within the Lloyds TSB Group s venture capital operations.

There was an improvement of £22 million in the Lloyds TSB Group s share of the results of joint venture operations, as the former Goldfish joint venture is now being wound up.

A loss of £15 million was incurred in 2004 on the sale of the Lloyds TSB Group s operations in Argentina, Colombia, Guatemala, Honduras and Panama.

At the end of 2004, the total capital ratio was 10.0 per cent. Risk-weighted assets increased by 12 per cent to £132,173 million, reflecting strong growth in consumer lending and mortgages, higher lending in Corporate Markets and the acquisition of a UK corporate loan portfolio towards the end of the year from Danske Bank which added risk-weighted assets of some £2,000 million. Balance sheet assets grew by £27,831 million, or 11 per cent to £279,843 million from £252,012 million. The Group s strategy to increase retail lending, particularly in mortgages, credit cards and personal loans was reflected in a 14 per cent increase in loans and advances to customers to £154,240 million. Customer deposits increased by £5,566 million, or 5 per cent, to £122,062 million largely as a result of strong growth in current account credit balances which was supported by further progress in the take-up of added value current accounts.

2003 compared with 2002

In 2003, Lloyds TSB Group s profit before tax increased by £1,730 million, or 66 per cent, to £4,348 million from £2,618 million in 2002; this increase in profitability largely reflects net gains of £865 million recognised in 2003 following the disposal of a number of businesses and a £934 million improvement in the return from the assets supporting the long-term assurance funds. Profit attributable to shareholders was 82 per cent higher at £3,254 million and earnings per share increased by 82 per cent to 58.3p. Shareholders equity increased by £1,681 million to £9,624 million. The post-tax return on average shareholders equity was 38.5 per cent, compared to 16.8 per cent in 2002. Economic profit increased by £1,663 million to £2,493 million; see Operating and financial review and prospects Economic profit . The post-tax return on average assets was 1.57 per cent, and the post-tax return on average risk-weighted assets was 2.63 per cent.

Total income was £1,021 million higher at £9,908 million, compared to £8,887 million in 2002. Lloyds TSB Group s net interest income increased by £84 million, or 2 per cent, to £5,255 million. Average interest-earning assets increased by £11,078 million, or 7 per cent, to £172,896 million, adding £284 million to net interest income. In the UK, average personal lending and mortgage balances increased by £10,140 million driven by the strong residential housing market and the continuing demand for consumer credit. Wholesale balances were £1,558 million higher as a result of increased asset finance lending and the full year effect of structured finance transactions entered into during 2002. Average balances overseas decreased by £720 million, following the reclassification at the end of 2002 to trading assets of the Lloyds TSB Group s portfolio of emerging markets debt securities. The effect of volume growth was partly offset by a 16 basis point fall in the net interest margin, reducing net interest income by £259 million; the implementation of the Competition Commission s SME report remedies caused the margin to reduce by 10 basis points. Favourable exchange movements increased net interest income by £59 million.

Other finance income, at £34 million, was down £131 million from £165 million in 2002. The expected return on pension scheme assets was £121 million lower, reflecting the significant reduction in market value of scheme assets at the end of 2002, as a result of stock market conditions. The interest charge in respect of the unwinding of the discount on scheme liabilities was £10 million higher, as the effect of the increased level of scheme liabilities at the start of 2003 has been partly offset by a lower discount rate.

16

Other income was £1,068 million, or 30 per cent, higher at £4,619 million compared to £3,551 million in 2002. Income from long-term assurance business was £747 million higher, mainly as a result of improved returns from the investments supporting the life funds. Dealing profits were £372 million higher, as a result of increases of £55 million in foreign exchange income and £317 million in gains from securities trading reflecting earnings from the sale of the Lloyds TSB Group s portfolio of emerging markets debt investments. General insurance premiums were £49 million higher as a result of strong growth in home insurance products. However, net fees and commissions receivable fell by £31 million as a reduction in income from insurance broking and higher fees payable within the asset finance and mortgage businesses more than offset growth in income from current accounts and credit and debit cards. Other operating income decreased by £69 million, following the recognition of earnings on the emerging markets debt portfolio in 2003 in dealing profits following its reclassification to trading assets at the end of 2002, and a reduction of £28 million in profits on the sale and leaseback of premises. This more than offset the effect of the inclusion of a full year s income from the Dutton-Forshaw Group which was acquired in December 2002, and higher disposal gains within the wholesale businesses.

Operating expenses were £260 million, or 5 per cent, higher at £5,173 million compared to £4,913 million in 2002, as a result of a £200 million provision for customer redress and the inclusion for a full year of the costs of businesses acquired in 2002 which increased operating expenses by £110 million in 2003. Administrative expenses were £264 million higher than in 2002. Staff costs increased by £71 million as the impact of acquisitions and the annual pay review more than offset the benefits of reductions in staff numbers and lower levels of restructuring costs. Premises and equipment costs were £1 million higher and other expenses increased by £192 million reflecting the inclusion of the customer redress provision. The cost: income ratio improved to 52.2 per cent from 55.3 per cent.

General insurance claims increased by £7 million to £236 million, as the effect of the increase in the size of the portfolio was offset by the beneficial effect of generally mild weather conditions.

The charge for bad and doubtful debts was 8 per cent lower at £950 million compared with £1,029 million in 2002. In UK Retail Banking the provisions charge increased by £98 million, or 20 per cent, to £594 million, mainly as a result of continued asset growth in the personal loan and credit card portfolios, however there was some deterioration in the arrears position and an increase in fraud related losses in the personal loan portfolio. In Wholesale and International Banking the provisions charge decreased by £171 million to £369 million. In Wholesale, provisions against the corporate lending portfolio decreased by £86 million as a small number of large provisions made in 2002 were not repeated. Within International Banking provisions fell by £93 million mainly as a result of lower provisions being required against the Lloyds TSB Group s exposures in Argentina.

Amounts written off fixed asset investments decreased by £43 million to £44 million in 2003. The charge in 2002 included £30 million in respect of Argentine emerging market bonds which were disposed of in 2003, and there was a reduction in the charge within the wholesale businesses.

In 2003, a profit of £865 million arose on the sale of The National Bank of New Zealand, substantially all of Lloyds TSB Group s businesses in Brazil and its French fund management and private banking businesses.

At the end of 2003, the total capital ratio increased to 11.3 per cent principally as a result of profit retentions and the effect of a £4,679 million, or 4 per cent, reduction in risk-weighted assets to £117,732 million, from £122,411 million at the end of 2002. The effect of growth in personal lending, partly as a result of the acquisition of the personal loan and credit card portfolios of Goldfish Bank, and mortgage lending was more than offset by a reduction of £10,110 million as a result of disposals. Balance sheet assets decreased by £549 million to £252,012 million; the effect of the disposals during 2003 reduced total assets by £14,602 million and there was therefore an underlying increase of £14,053 million. This underlying increase was largely attributable to growth in loans and advances to customers with higher period end UK mortgage and personal lending balances.

Net interest income

The yields, spreads and margins in the table below are those relating to the banking business only.

	2004	2003	2002
Net interest income £m	**4,920**	5,255	5,171
Average interest-earning assets £m	**178,981**	172,896	161,818
Average rates:			
Gross yield on interest-earning assets %1	**5.81**	5.87	6.52
Interest spread %2	**2.61**	2.91	2.94
Net interest margin %3	**2.75**	3.04	3.20
Margin excluding discontinued operations and average balances held under reverse repurchase agreements4			
Net interest income £m	**4,920**	4,744	4,683
Average interest-earning assets £m	**170,225**	158,167	146,154
Net interest margin %	**2.89**	3.00	3.20

1 Gross yield is the rate of interest earned on average interest-earning assets.

2 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.

3 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.

4 Comparisons of net interest income and margins between 2004, 2003 and 2002 are distorted by the trading results, in 2002 and 2003, of the businesses sold during 2003 and by the substantial growth, during 2004, in holdings of fine margin reverse repurchase agreements. To improve comparability, figures are also shown which exclude the net interest income (2003: £511m; 2002: £488m) and average interest-earning assets (2003: £13,490m; 2002: £12,918m) of the discontinued operations from the comparative periods and which exclude the average balances held under reverse repurchase agreements (2004: £8,756m; 2003: £1,239m; 2002: £2,746m).

2004 compared with 2003

Net interest income decreased by £335 million, or 6 per cent, to £4,920 million compared to £5,255 million in 2003. However, comparisons of net interest income are distorted by the inclusion, in the comparative figures, of the income earned by the businesses disposed of in 2003; excluding these discontinued operations, net interest income rose by £176 million, or 4 per cent, to £4,920 million in 2004 compared to £4,744 million in 2003.

Average interest-earning assets grew by £6,085 million, or 4 per cent, to £178,981 million in 2004 compared to £172,896 million in 2003. However, comparisons of average interest-earning assets are distorted by the discontinued operations in 2003 and the substantial growth, during 2004, in fine margin but capital efficient reverse repurchase agreements held for liquidity purposes. Excluding discontinued operations from the comparative figures and the balances held under reverse repurchase agreements from both years, average interest-earning assets grew by £12,058 million, or 8 per cent, to £170,225 million in 2004 compared to £158,167 million in 2003; this growth added £351 million to net interest income. Average balances within UK Retail Banking were £10,875 million higher, reflecting strong growth in mortgages (up 13 per cent), personal loans and overdrafts (together, up 12 per cent) and credit card balances. Average credit card balances were 25 per cent higher overall, reflecting the full year impact of the Goldfish portfolios acquired at the end of September 2003 together with underlying growth of 12 per cent. Within Wholesale and International Banking average interest-earning assets, excluding discontinued operations and reverse repurchase agreements, were £578 million higher. Increased business activity lead to an increase of £1,536 million in corporate lending balances and £1,314 million within the asset finance businesses, where there has been a change in mix towards traditional lending rather than operating leases. Treasury balances, excluding reverse repurchase agreements, were lower, and balances in the International businesses, excluding discontinued operations, fell as growth in offshore lending was more than offset by further contractions in Latin America and by reductions in corporate lending balances in mainland Europe.

The Lloyds TSB Group s net interest margin fell by 29 basis points to 2.75 per cent in 2004, compared to 3.04 per cent in 2003. However, excluding discontinued operations from the comparative figures and balances held under reverse repurchase agreements from both years, the net interest margin fell by 11 basis points to 2.89 per cent in 2004 compared to 3.00 per cent in 2003; this fall in margin reduced net interest income by £173 million. Within UK Retail Banking, competitive pressures lead to reductions in the margins on mortgages, overdrafts and personal loans. Within Wholesale and International Banking, excluding discontinued operations and balances held under reverse repurchase agreements, there was margin growth in corporate lending and on asset finance balances (due to a change in mix towards higher margin consumer balances) but business banking margins tightened, again as a result of competitive pressures leading to the offering of specially priced term lending products; within the International businesses, excluding discontinued operations, there were margin reductions on offshore lending.

Exchange rate movements in the Lloyds TSB Group s overseas operations, excluding discontinued operations, lead to a reduction of £2 million in net interest income.

2003 compared with 2002

Lloyds TSB Group net interest income increased by £84 million, or 2 per cent, to £5,255 million, representing 53 per cent of total income compared to 58 per cent in 2002; businesses disposed of during 2003 contributed £511 million of this total compared to £488 million in 2002. Excluding the net interest income of these discontinued operations from the totals in both years, net interest income of £4,744 million in 2003 was £61 million, or 1 per cent, higher than £4,683 million in 2002.

Average interest-earning assets increased by £11,078 million, or 7 per cent, to £172,896 million. However, interpretations of movements in average interest-earning assets are complicated by the assets held in the businesses sold in 2003 and by the levels of very fine margin, but capital efficient, reverse repurchase agreements held for liquidity and funding purposes. Excluding these discontinued operations and the holdings of reverse repurchase agreements, average interest-earning assets grew by £12,013 million or 8 per cent, to £158,167 million in 2003 compared to £146,154 million in 2002; this growth added £362 million to net interest income. Within UK Retail Banking continued strong growth led to increases of £2,173 million in average personal lending and credit card balances and £7,424 million in average mortgage balances. Within Wholesale and International Banking, excluding discontinued operations and average balances held under reverse repurchase agreements, average interest-earning assets increased by £2,945 million, reflecting growth in asset finance balances and the full year effect of structured finance transactions entered into during 2002 which more than offset a reduction in balances within the Lloyds TSB Group s treasury operations, excluding balances held under reverse repurchase agreements, due to fewer market opportunities in 2003. Overseas, excluding discontinued operations, reductions following the contraction of the Lloyds TSB Group s other Latin American operations were more than offset by growth in corporate lending in mainland Europe. There was also a reduction of £1,207 million following the reclassification as trading assets and subsequent disposal of the Lloyds TSB Group s portfolio of emerging markets debt securities.

The net interest margin fell by 16 basis points to 3.04 per cent from 3.20 per cent in 2002, reducing net interest income by £259 million. The implementation of the Competition Commission s SME report remedies caused a reduction in the Group net interest margin of 10 basis points costing £169 million. Excluding discontinued operations, and the average balances held under reverse repurchase agreements, the net interest margin fell by 20 basis points from 3.20 per cent in 2002 to 3.00 per cent in 2003, reducing net interest income by £299 million, of which £169 million was due to the impact of the Competition Commission s SME report remedies. There was some margin erosion within the mortgages business and on credit card balances and personal overdrafts although there was some improvement in the margin on personal loans. The margin was further reduced by both the continuing change in the composition of the lending portfolio towards finer margin products and the disposal of the high yielding emerging markets investments. Adverse exchange rate movements, excluding discontinued operations, decreased net interest income by £2 million.

Other income

	2004	2003	2002
	£m	£m	£m
Fees and commissions receivable:			
UK current account fees	**637**	623	579
Other UK fees and commissions	**1,243**	1,173	1,163
Insurance broking	**586**	604	647
Card services	**520**	439	394
International fees and commissions	**138**	148	159
	3,124	2,987	2,942
Fees and commissions payable	**(744)**	(688)	(614)
Dealing profits (before expenses):			
Foreign exchange trading income	**178**	223	143
Securities and other gains	**93**	302	21
	271	525	164
Income from long-term assurance business	**715**	436	(305)
General insurance premium income	**554**	535	486
Other operating income	**688**	682	759
Total other income continuing operations	**4,608**	4,477	3,432
Discontinued operations		142	119
Total other income	**4,608**	4,619	3,551

2004 compared with 2003

Other income decreased by £11 million to £4,608 million compared to £4,619 million in 2003. However, the businesses that were sold in 2003 contributed £142 million of other income in that year and, excluding these discontinued operations from the comparative figures, other income rose by £131 million, or 3 per cent, to £4,608 million in 2004 from £4,477 million in 2003.

Fees and commissions receivable, excluding discontinued operations, increased by £137 million, or 5 per cent, to £3,124 million from £2,987 million in 2003. UK current account fees were £14 million higher than in 2003 as a result of the continuing growth in added value account products and a review of charging policies, although within this figure there has been a reduction of £3 million in unauthorised borrowing fees. Other UK fees and commissions were £70 million higher at £1,243 million, compared to £1,173 million in 2003. Company registration fees were £15 million higher as a result of a significant increase in activity at Lloyds TSB Registrars, both in terms of sharedealing volumes and corporate actions. Mortgage fees were £16 million higher, reflecting both continued growth in the mortgage book and some increase in fee levels during 2004. Unit trust fees were £18 million higher reflecting both growth in asset values, and therefore annual management fees, at Scottish Widows and increased volumes within the offshore business. There was also good growth in corporate banking fees, reflecting a number of large deals completed in 2004, and in acceptance fees. Insurance broking commissions were £18 million lower, at £586 million in 2004 compared to £604 million in 2003, as a result of lower levels of retrospective and motor insurance broking commissions, only partly offset by an increase in income from creditor protection products. Fee income from card services, excluding discontinued operations, was £81 million higher; this reflects a full year s income from the Goldfish business, which was acquired by the Lloyds TSB Group at the end of September 2003, and a review of pricing and charging policies. International fees and commissions, excluding discontinued operations, were £10 million lower at £138 million compared to £148 million in 2003.

Fees and commissions payable, excluding discontinued operations, were £56 million or 8 per cent, higher at £744 million compared to £688 million in 2003. Commissions payable to motor dealers in the asset finance business were £33 million higher, as a result of the continued growth in business volumes. Fees payable within the card services business were £34 million higher reflecting the acquisition of the Goldfish business at the end of September 2003; this increase was partly offset by some reduction in the level of other fees payable within UK Retail Banking.

Dealing profits, excluding discontinued operations, were £254 million, or 48 per cent, lower at £271 million compared to £525 million in 2003. Foreign exchange income was £45 million lower at £178 million as good growth in income within the Lloyds TSB Group s treasury and corporate banking operations was more than offset by the non-repetition of income earned at the Group centre from the closure of certain foreign exchange positions in 2003. Securities trading gains were £209 million lower; again, good growth within the Lloyds TSB Group s treasury operations was more than offset by the fact that 2003 included substantial profits on the sale of the remaining assets within the Lloyds TSB Group s portfolio of emerging markets debt securities.

Income from long-term assurance business, excluding discontinued operations, was £279 million higher at £715 million, compared to £436 million in 2003. The new business contribution, excluding discontinued operations, was £92 million higher, reflecting growth in business volumes and an improved margin on new products, and the expected return on existing business was £25 million higher. There was an £88 million reduction in charges for customer remediation provisions (£12 million in 2004 compared to £100 million in 2003) and improved market conditions lead to a £41 million increase in the overall return on investments held to support the long-term funds.

Premium income from general insurance underwriting was £19 million, or 4 per cent, higher at £554 million compared to £535 million in 2003. This reflected improved income on home contents and creditor insurance, including policies sold with the Lloyds TSB Group s asset finance business, only partly offset by a reduction in health insurance premiums.

Other operating income, excluding discontinued operations, was £6 million higher as an increase in gains on sale of investments, mainly within the Lloyds TSB Group s venture capital business, was partly offset by a reduction in operating lease rentals receivable and in income from the Lloyds TSB Group s motor dealerships, which were rationalised towards the end of 2003.

2003 compared with 2002

Other income increased by £1,068 million, or 30 per cent, to £4,619 million; of this total businesses disposed of during 2003 accounted for £142 million compared to £119 million in 2002; excluding discontinued operations, other income increased by £1,045 million, or 30 per cent, to £4,477 million.

Fees and commissions receivable, excluding discontinued operations, increased by £45 million mainly as a result of good growth in UK current account fees and improved income from credit and debit card transactions, which more than offset a reduction in insurance broking commissions. UK current account fee income rose by £44 million, reflecting increased fee income from added value current accounts due to both a growth in the number of accounts and higher monthly charges; returned cheque fees also increased as the number of returned items rose.

Other UK fees and commissions increased by £10 million. Fees earned by the mortgages business rose by £20 million reflecting the growth in new mortgage lending during 2003 and an increase in the arrangement fee charged to customers. There was a £14 million increase in the fees charged in connection with the early settlement of personal loans following their introduction in the second half of 2002 and fees from large corporate and factoring activity increased by £16 million. There was also an increase in fees receivable within the asset finance business; acceptance fees were £7 million higher and collection fees grew by £8 million as a result of volume growth. This growth was largely offset by a reduction of £27 million in unit trust and asset management fees reflecting lower average fund values and the continued weakness of the long-term savings market. Fee income from stockbroking activities reduced reflecting lower transaction volumes in weak market conditions and income from the company registration business also fell as levels of corporate activity remained subdued.

Income from credit and debit card services increased by £45 million mainly as a result of a growth in interchange income, partly reflecting the acquisition of the Goldfish credit card portfolio during 2003, higher overseas use commissions and other fees.

Insurance broking commission income decreased by £43 million as a result of a £75 million fall in income from creditor insurance, reflecting a reduction in the level of sales achieved through the branch network and an increase of £35 million in the allowance in respect of the clawback of commissions relating to personal loans which are being settled early, which more than offset a £55 million increase in retrospective commissions. International fees and commissions reduced by £11 million mainly due to lower fund management fees in a number of locations.

Fees and commissions payable, excluding discontinued operations, were £74 million higher compared to 2002 as a result of a £36 million increase in commissions paid to motor dealers by the asset finance operation, reflecting growth in the levels of new business, and higher costs relating to legal expenses and valuation fee incentives supporting the strong mortgage growth. Fees payable in respect of the credit and debit card business also increased, mainly reflecting volume growth and the cost of customer incentives, and there was also an increase in fees payable in connection with the Lloyds TSB Group s added value accounts as volumes increased.

Dealing profits, excluding discontinued operations, increased substantially by £361 million compared with 2002 as a result of an increase of £80 million in foreign exchange income and an increase of £281 million in gains from securities trading, largely reflecting profits from the disposal of the Lloyds TSB Group s portfolio of emerging markets debt investments which, at the end of 2002, was reclassified as a trading asset. In 2002, earnings from emerging markets debt investments were primarily reported within other operating income.

Income from long-term assurance business, excluding discontinued operations, increased by £741 million reflecting the improved performance of stock markets during 2003 as the return on the investments held to support the long-term assurance funds grew by £934 million. Although there was only limited growth in overall product sales, new business contribution increased by £8 million largely reflecting an improved new business margin caused by a shift to more profitable regular premium products. Profits from existing business fell by £111 million mainly as a result of a £168 million reduction in benefits from experience variances and actuarial assumption changes, and the expected return reduced by £48 million; however, provisions for customer redress were £105 million lower. The benefits from economic assumption changes also reduced by £77 million.

Premium income from general insurance underwriting increased by £49 million, or 10 per cent, to £535 million, compared to £486 million in 2002. There was growth of £60 million in premiums from home insurance products, reflecting successful cross-selling to the Lloyds TSB Group s mortgage customers and the continued strength of the UK housing market, partly offset by a £7 million increase in reinsurance premiums due to increased rates in the reinsurance market and higher underwritten premiums.

Other operating income, excluding discontinued operations, decreased by £77 million to £682 million mainly due to the change in treatment of earnings from the emerging markets debt investments portfolio following the reclassification of the portfolio as a trading asset at the end of 2002. There was also a further £28 million reduction in profits from the sale and leaseback of premises, which in 2003 totalled £4 million. These factors more than offset the effect of the inclusion of income from the sale of cars by the Dutton-Forshaw Group following its acquisition in December 2002, which increased by £51 million, and a £26 million increase in the gains on realisation of venture capital investments by Lloyds TSB Development Capital. There were also gains of £34 million following the sale of a number of leases by Lloyds TSB Leasing where the tax attributes could be used by the purchasers.

Operating expenses

	2004	2003	2002
	£m	£m	£m
Administrative expenses:			
Staff:			
Salaries	**1,793**	1,675	1,646
National insurance	**140**	137	128
Pensions	**338**	342	303
Other staff costs	**276**	277	294
	2,547	2,431	2,371
Premises and equipment:			
Rent and rates	**274**	271	268
Hire of equipment	**17**	17	18
Repairs and maintenance	**129**	123	127
Other	**110**	114	109
	530	525	522
Other expenses:			
Communications and external data processing	**439**	411	411
Advertising and promotion	**163**	160	135
Professional fees	**141**	118	107
Provisions for customer redress	**100**	200	
Other	**364**	384	427
	1,207	1,273	1,080
Administrative expenses	**4,284**	4,229	3,973
Depreciation	**589**	633	630
Amortisation of goodwill	**44**	39	33
Total operating expenses continuing operations	**4,917**	4,901	4,636
Discontinued operations		272	277
Total operating expenses	**4,917**	5,173	4,913
Cost: income ratio (%)	**51.4**	52.2	55.3
Cost: income ratio excluding discontinued operations (%)	**51.4**	53.0	56.0

2004 compared with 2003

Operating expenses were £256 million, or 5 per cent, lower at £4,917 million compared to £5,173 million in 2003. However, operating expenses in 2003 included £272 million incurred in the businesses sold in that year and, excluding these discontinued operations from the comparative figures, operating expenses in 2004 were £16 million higher at £4,917 million, compared to £4,901 million in 2003.

Administrative expenses, excluding discontinued operations, were £55 million, or 1 per cent, higher at £4,284 million compared to £4,229 million in 2003. Staff costs were £116 million, or 5 per cent, higher. This increase reflected the annual pay increase and an increased charge in respect of profit related and other staff incentive schemes, which in particular reflected the impact of growth in the Lloyds TSB Group s corporate banking business; the pensions charge was little changed as an increase in the regular cost arising in respect of the Lloyds TSB Group s defined benefit schemes was offset by a reduced past service cost reflecting a lower level of rationalisation activity than in 2003. Other staff costs were also largely unchanged as a reduction in restructuring costs was offset by an increase in charges related to outsourced activities.

Premises and equipment costs, excluding discontinued operations, were £5 million, or 1 per cent, higher at £530 million, compared to £525 million in 2003. Small increases in rent and rates payable, in part reflecting sale and leaseback deals in recent years, and higher repair and maintenance costs were partly offset by a decrease in other premises and equipment costs, as a result of gains on disposal of premises.

Other expenses, excluding discontinued operations, were £66 million, or 5 per cent, lower at £1,207 million. However, this figure includes the charge in respect of provisions for customer redress within the Lloyds TSB Group s banking operations which was £100 million compared to £200 million in 2003. Excluding this item, other expenses were £34 million, or 3 per cent, higher at £1,107 million compared to £1,073 million in 2003. Communications and external data processing costs were £28 million higher reflecting the impact of the Goldfish business, acquired at the end of September 2003, and increased telephony costs. Advertising and promotion costs were £3 million higher and professional fees rose by £23 million reflecting the cost of assistance with a number of large projects, including Basel and the implementation, in the United Kingdom, of International Financial Reporting Standards from 1 January 2005. Other costs were £20 million lower, reflecting lower operational losses and reduced charges related to the Lloyds TSB Group s clearings joint venture.

Depreciation, excluding discontinued operations, was £44 million lower due to a reduced charge in respect of operating lease assets reflecting a change in the mix of this business towards longer-term deals, such as aircraft, and the non-repetition of an accelerated charge suffered in 2003.

Goodwill amortisation, excluding discontinued operations, was £5 million higher at £44 million, compared to £39 million in 2003, as a result of the acquisition of the Goldfish business.

The cost:income ratio improved to 51.4 per cent compared to 52.2 per cent in 2003, or 53.0 per cent excluding discontinued operations from the comparative figures.

2003 compared with 2002

Total operating expenses increased by £260 million, or 5 per cent, to £5,173 million; of this total, businesses disposed of during 2003 accounted for £272 million compared to £277 million in 2002; excluding discontinued operations, total operating expenses increased by £265 million, or 6 per cent, to £4,901 million. The impact of acquisitions made in 2002 increased operating expenses during 2003 by £110 million, and there was a £200 million provision for customer redress.

Administrative expenses, excluding discontinued operations, increased by £256 million to £4,229 million, largely reflecting the £200 million provision for customer redress. Staff costs were £60 million higher at £2,431 million. Salaries were £29 million, or 2 per cent, higher as the impact of the annual pay review and the acquisitions made during 2002 more than offset the effect of an underlying reduction in staff numbers of 1,209 (full time equivalent); the cost of bonuses and other performance related payments remained broadly unchanged. National Insurance costs grew by £9 million reflecting the higher overall salary bill and the increase in employers contribution rates which took effect in April 2003. Pension costs increased by £39 million, or 13 per cent, reflecting a growth in the current service cost as interest rates have fallen and an increase in the level of cash contributions being made into defined contribution schemes in the UK. Other staff costs fell by £17 million because the impact of increased use of agency and other contract staff to support a number of major IT development projects and a significant increase in training costs, particularly for staff working in the branch network, was more than offset by a reduction in severance and related costs following the completion of a number of major restructuring initiatives.

Premises and equipment costs were £3 million higher; there was little change in costs during 2003 as the effect of branch closures offset the impact of acquisitions made during 2002.

Other expenses increased by £193 million, largely as a result of the £200 million provision for customer redress and related costs in respect of past sales of mortgage endowment and long-term savings products, including the Extra Income & Growth Plan. Advertising expenditure increased by £25 million mainly reflecting promotional expenditure incurred in connection with the credit card and mortgage businesses and also wider use of television advertising during 2003; professional fees increased by £11 million due to greater use of external consultants on a number of major projects. This has been offset by a £43 million reduction in other expenses. There has been a reduction in the processing charges paid to iPSL, Lloyds TSB Group s clearings joint venture, and reduced credit and debit card fraud losses.

Depreciation, excluding discontinued operations, rose by £3 million. Operating lease depreciation increased by £19 million as an accelerated charge was recorded following the reassessment of the carrying value of a small number of big ticket operating lease assets; the effect of the acquisition of First National Vehicle Holdings during 2002 was largely offset by the reduction in the size of the existing portfolios. This was offset by a £16 million reduction in the charge on other fixed assets, mainly reflecting the accelerated write-off of certain software development costs in 2002. Goodwill amortisation, excluding discontinued operations, was £6 million higher reflecting the acquisitions made during 2002 and 2003.

The cost:income ratio was 52.2 per cent, compared to 55.3 per cent in 2002. Excluding discontinued operations, the cost:income ratio was 53.0 per cent compared to 56.0 per cent in 2002.

Charge for bad and doubtful debts

	2004	2003	2002
	£m	£m	£m
UK Retail Banking	**673**	594	496
Wholesale and International Banking	**193**	306	489
Central group items		(13)	(7)
Total charge, excluding discontinued operations	**866**	887	978
Discontinued operations		63	51
Total charge	**866**	950	1,029
Specific provisions	**953**	946	965
General provisions	**(87)**	4	64
Total charge	**866**	950	1,029
Charge as % of average lending:	**%**	%	%
Total charge	**0.59**	0.66	0.77
Total charge, excluding discontinued operations	**0.59**	0.66	0.80

2004 compared with 2003

The total charge for bad and doubtful debts decreased by £84 million, or 9 per cent, to £866 million compared to £950 million in 2003. However, the charge in 2003 included £63 million in the businesses sold in that year and, excluding these discontinued operations from the comparative figures, the charge for bad and doubtful debts in 2004 was £21 million, or 2 per cent, lower at £866 million compared to £887 million in 2003.

The charge within UK Retail Banking was £79 million higher at £673 million compared to £594 million in 2003. The charge in respect of personal loans and overdrafts was £43 million higher, principally reflecting volume growth. The charge in respect of credit cards was £60 million higher; £37 million of the increase reflected the acquisition of the Goldfish business and the remainder is attributable to the growth in the size of the lending portfolios. There was a net provisions release of £42 million in respect of the mortgage business, £24 million higher than in 2003, reflecting the continuing low level of losses as a result of rising house prices and historically low interest rates.

The charge in respect of Wholesale and International Banking, excluding discontinued operations, was £113 million lower at £193 million compared to £306 million in 2003. There was a reduction in the charge in respect of corporate lending, as a result of both lower new charges and some large releases, and a release of £30 million from the general provision that was held in respect of the Lloyds TSB Group s exposures in Argentina. These factors more than offset an increased charge in the asset finance business, as a result of volume growth.

The credit in respect of Central group items of £13 million in 2003 was not repeated as the remainder of the Lloyds TSB Group s portfolio of medium-term emerging markets debt was sold or repaid during 2003.

Overall, the Lloyds TSB Group s charge for bad and doubtful debts as a percentage of average lending fell to 0.59 per cent, compared to 0.66 per cent in 2003.

2003 compared with 2002

The total charge for bad and doubtful debts decreased by £79 million, or 8 per cent, to £950 million; businesses disposed of during 2003 accounted for £63 million of this charge compared to £51 million in 2002; excluding discontinued operations, the total charge for bad and doubtful debts decreased by £91 million, or 9 per cent, to £887 million.

In UK Retail Banking the provisions charge increased to £594 million from £496 million in 2002. There was a net release from the provisions held against the mortgages portfolio of £18 million compared to a net release of £1 million in 2002, reflecting an improved arrears position and an increase in the value of the property held as security. The charge in respect of other lending increased by £115 million mainly due to an increase in the provisions required against the personal loan and credit card portfolios. This is largely attributable to the growth in the size of these portfolios although there was also some deterioration in arrears levels and an increase in fraud related losses within the personal lending portfolio.

In Wholesale and International Banking, excluding discontinued operations, the provisions charge fell by £183 million to £306 million. The charge within Wholesale fell by £78 million as the level of new provisions required against corporate customers reduced. In 2002 provisions totalling some £100 million were made against large US exposures which were not repeated to the same extent during 2003. In the asset finance businesses the provisions charge was largely unchanged despite strong lending growth during 2003 as the high level of voluntary terminations experienced in 2002 were not repeated during 2003. Within International Banking, excluding discontinued operations, the charge fell by £105 million mainly as a result of a reduction of £79 million in the new provisions required against the Lloyds TSB Group s exposures in Argentina as the economic conditions in that country started to stabilise. There was also a reduction in the charge in other Latin American operations as specific cases requiring provisions in 2002 were not repeated.

Within Central group items there was a net release of provisions of £13 million from the provisions held against medium-term debt in the emerging markets portfolio. This portfolio has now either been disposed of or the lending has been repaid.

The Lloyds TSB Group s charge for bad and doubtful debts as a percentage of average lending decreased to 0.66 per cent, compared to 0.77 per cent in 2002; excluding discontinued operations, the charge for bad and doubtful debts as a percentage of average lending decreased to 0.66 per cent compared to 0.80 per cent in 2002.

Taxation

The rate of tax is influenced by the geographic and business mix of profits. In the absence of special factors, Lloyds TSB Group does not expect the tax rate to vary significantly from the average UK corporation tax rate.

	2004	2003	2002
	£m	£m	£m
UK corporation tax:			
Current tax on profits for the year	**841**	1,079	786
Adjustments in respect of prior years	**(38)**	(72)	12
	803	1,007	798
Double taxation relief	**(58)**	(223)	(129)
	745	784	669
Foreign tax:			
Current tax on profits for the year	**119**	144	216
Adjustments in respect of prior years	**(5)**	(15)	(15)
	114	129	201
Current tax charge	**859**	913	870
Deferred tax	**146**	119	(106)
Associated undertakings and joint ventures	**(1)**	(7)	2
Total charge	**1,004**	1,025	766

2004 compared with 2003

The effective rate of tax in 2004 was 28.7 per cent, compared to an effective rate of tax in 2003 of 23.6 per cent and the corporation tax rate in 2004 of 30 per cent. The higher effective rate of tax in 2004 is primarily because the effective rate in 2003 benefited from the fact that the gain on disposal of The National Bank of New Zealand was exempt from taxation; this was only partly offset by the benefit, in 2004, of lower effective rates of tax in the Lloyds TSB Group s life and pensions businesses, due to an improved performance in the investment portfolios. See note 9 to the financial statements.

2003 compared with 2002

The effective rate of tax in 2003 was 23.6 per cent, compared to an effective rate of tax of 29.3 per cent in 2002 and the corporation tax rate in 2003 of 30 per cent. The lower effective rate of tax in 2003 was primarily due to the gain on disposal of The National Bank of New Zealand, which was exempt from taxation, and a reduction in the non-allowable element of foreign taxes paid creditable against the UK corporation tax charge. This was partly offset by the withdrawal of tax relief on payments to the Lloyds TSB Group qualifying share ownership trust (QUEST) to satisfy Save As You Earn options.

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 three 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.

	2004	2003	2002
	£m	£m	£m
Average shareholders equity	**9,956**	8,460	10,672
Profit attributable to shareholders	**2,421**	3,254	1,790
Less: notional charge	**(896)**	(761)	(960)
Economic profit	**1,525**	2,493	830

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

2004 compared with 2003

Economic profit decreased to £1,525 million in 2004 compared to £2,493 million in 2003. Profit attributable to shareholders decreased by £833 million, or 26 per cent, to £2,421 million principally due to the significant profits on disposal of businesses in 2003 of £865 million, on which no tax charge arose; the notional charge on average equity was £135 million higher, as a result of an 18 per cent increase in average equity to £9,956 million compared to £8,460 million in 2003.

2003 compared with 2002

Economic profit increased by £1,663 million from £830 million in 2002 to £2,493 million in 2003. Profit attributable to shareholders increased by £1,464 million, or 82 per cent, to £3,254 million; the notional charge on average equity was £199 million lower, as a result of a 21 per cent reduction in average equity to £8,460 million from £10,672 million in 2002.

Line of business information

Summary

In order to provide a clearer representation of the underlying performance, the results of the Insurance and Investments segment include investment earnings calculated using longer-term rates of return and annual management charges based on unsmoothed fund values. Management separately analyse the difference between these normalised earnings and the actual return (the investment variance) together with the impact of changes in the economic assumptions used in the embedded value calculation. The results of the businesses are set out below:

	2004	2003	2002
	£m	£m	£m
UK Retail Banking	**1,651**	1,471	1,548
Insurance and Investments	**773**	565	638
Wholesale and International Banking continuing operations	**1,272**	1,038	1,005
Central group items	**(333)**	(12)	36
	3,363	3,062	3,227
Changes in economic assumptions	**(2)**	(22)	55
Investment variance	**147**	125	(943)
Loss on sale of businesses in 2004	**(15)**		
Discontinued operations in 2003 and 2002		1,183	279
Profit before tax	**3,493**	4,348	2,618

Comparative figures for 2003 and 2002 have been restated to reflect changes in the Lloyds TSB Group s segmental analysis following the introduction, in 2004, of the management of the Lloyds TSB Group s distribution channels as profit centres and other changes in internal transfer pricing arrangements. The loss on sale of businesses in 2004 and discontinued operations in 2003 and 2002 relate to the Wholesale and International Banking segment. The discontinued operations in 2003 and 2002 were the Lloyds TSB Group s operations in New Zealand, Brazil and France, sold in 2003.

26

UK Retail Banking

	2004	2003	2002
	£m	£m	£m
Net interest income	**3,198**	3,137	2,890
Other income	**1,639**	1,533	1,567
Total income	**4,837**	4,670	4,457
Operating expenses	**(2,513)**	(2,583)	(2,402)
Trading surplus	**2,324**	2,087	2,055
Provisions for bad and doubtful debts	**(673)**	(594)	(496)
Share of results of joint ventures		(22)	(11)
Profit before tax	**1,651**	1,471	1,548
Profit before tax, before provisions for customer redress	**1,751**	1,671	1,548
Cost:income ratio	**52.0%**	55.3%	53.9%
Total assets (year-end)	**£101,615m**	£90,541m	£79,629m
Total risk-weighted assets (year-end)	**£60,502m**	£54,119m	£48,313m

Restated, as explained on page 26.

2004 compared with 2003

Profit before tax from UK Retail Banking increased by £180 million, or 12 per cent, to £1,651 million, compared to £1,471 million in 2003. However, comparisons of performance are distorted by the level of the charge made in respect of provisions for customer redress, which was £100 million in 2004 compared to £200 million in 2003; excluding these provisions for customer redress, profit before tax in UK Retail Banking increased by £80 million, or 5 per cent to £1,751 million from £1,671 million in 2003.

Total income rose by £167 million, or 4 per cent, to £4,837 million compared to £4,670 million in 2003. Net interest income was £61 million, or 2 per cent, higher at £3,198 million, compared to £3,137 million in 2003. Average interest-earning assets were £10,875 million higher than in 2003. There was strong growth in mortgage lending during the year; gross new mortgage lending was £26,251 million, compared to £24,151 million in 2003, representing a market share of 9.0 per cent. Net new mortgage lending of £9,315 million was 12 per cent higher than the £8,283 million achieved in 2003 and represented a market share of 9.2 per cent. Mortgage balances outstanding increased by 13 per cent to £80,065 million. There was also good growth in personal loans and overdrafts, where average balances were £1,141 million higher and in card services, where average balances were £1,424 million higher, in part reflecting the acquisition of the Goldfish business at the end of September 2003. This volume growth generated an additional £387 million of net interest income.

The net interest margin, however, fell by 41 basis points, reducing net interest income by £326 million, reflecting in part continuing competitive pressures in mortgages and in other retail lending products such as overdrafts and personal loans.

Other income was £106 million, or 7 per cent, higher at £1,639 million compared to £1,533 million in 2003. This increase reflects the acquisition of the Goldfish business in 2003, as a result of which the 2004 figures include a full year s fee income compared to only three months in 2003. This lead to a significant increase in card fee income, up £81 million overall, only partly offset by a related increase in card fees payable. Card fee income also grew as a result of organic growth in the Lloyds TSB Group s existing business and a review of charging structures. Current account fees within UK Retail Banking were £13 million higher as a result of continued growth in added value account fees and an increased level of returned cheque fees. There were also increased management fees with the UK Wealth Management business, as a result of higher asset values.

Operating expenses were £70 million, or 3 per cent, lower at £2,513 million compared to £2,583 million in 2003. However, excluding the effect of the provisions for customer redress, operating expenses were £30 million, or 1 per cent, higher at £2,413 million compared to £2,383 million in 2003. The full year impact of the Goldfish acquisition and the effect of annual pay awards was partly offset by a lower level of bonuses in some areas and staff reductions, particularly in the distribution network; staff numbers at 31 December 2004 were 43,732, down 563 from 44,295 at the end of 2003. The cost:income ratio improved to 52.0 per cent from 55.3 per cent in 2003. Excluding the charges in respect of provisions for customer redress of £100 million in 2004 and £200 million in 2003, the cost:income ratio improved to 49.9 per cent in 2004 compared to 51.0 per cent in 2003.

Provisions for bad and doubtful debts were £79 million, or 13 per cent, higher at £673 million compared to £594 million in 2003. Of this increase, £37 million is attributable to the full year impact of the Goldfish business and the remainder reflects organic growth in the lending portfolios during 2004. Personal loan balances increased by £1,126 million, or 12 per cent, to £10,745 million over 2004 and credit card balances increased by £792 million, or 12 per cent, to £7,519 million. The provisions charge as a percentage of average lending for personal loans and overdrafts fell to 4.20 per cent, from 4.25 per cent in 2003, while the charge in the credit card portfolio increased to 3.42 per cent, from 3.19 per cent in 2003. In the mortgages business, there was a net provision release of £42 million, reflecting the continuing low level of losses in a climate of rising house prices and historically low interest rates. The provisions charge as a percentage of average lending was 0.71 per cent, compared to 0.72 per cent in 2003, and the overall arrears position remained satisfactory.

2003 compared with 2002

Profit before tax from UK Retail Banking decreased by £77 million, or 5 per cent, to £1,471 million, compared to £1,548 million in 2002. However, the results in 2003 were adversely affected by a £200 million provision for remediation payments to customers in respect of past sales of mortgage endowment and long-term savings products, principally the Extra Income & Growth Plan; adjusting for this provision there was a £123 million or 8 per cent growth in profit.

Total income increased by £213 million, or 5 per cent, to £4,670 million. Net interest income increased by £247 million, or 9 per cent, to £3,137 million as continued growth in lending and deposit balances added £379 million to net interest income partly offset by a reduction of £132 million caused by a 19 basis point reduction in the net interest margin. There was good organic growth in the personal loan and credit card businesses with outstanding balances increasing by 9 per cent and 18 per cent respectively over the year; after taking account of the impact of the acquisition of the Goldfish Bank portfolios, outstanding personal loan balances had increased by 10 per cent and credit card balances by 36 per cent by the end of December 2003. Over the twelve months to 31 December 2003, mortgage balances outstanding increased by 13 per cent to £70,750 million as net new lending increased to £8,283 million from £5,889 million; this represented an improved market share of 8.2 per cent although it remained below the Lloyds TSB Group s market share of outstanding mortgages.

The net interest margin was 19 basis points lower. There was margin contraction in the mortgages business as competitive pressures caused a move to discounted and finer margin products; the margin on retail savings products also fell as the full effect of interest rate falls was not passed on to customers and the benefit of low interest and interest-free current accounts was reduced. This was partly offset by an improved margin on personal loans, which benefited from lower funding costs.

Other income decreased by £34 million to £1,533 million. Fees earned from current account activity grew by £44 million reflecting increased volumes of added value accounts and higher monthly charges; returned cheque fees also increased as the number of returned items rose. There was also improved income from credit and debit card transactions, which increased by £46 million, mainly as a result of a growth in interchange income, higher overseas use commissions and other fees. These increases, however, were more than offset by a reduction in distribution commissions received for the sale of insurance products through the branch network and higher fees payable in respect of the credit card business, mainly reflecting volume growth and the cost of customer incentives, and increased package costs incurred on the added value account range as volumes have risen. A growth in fee income in the mortgages business, as lending volumes have grown and charges increased, has been offset by the higher cost of customer incentives.

Operating expenses were £181 million, or 8 per cent higher, at £2,583 million compared to £2,402 million in 2002 as a result of the £200 million provision for customer redress; if this is excluded operating expenses fell by £19 million. There was an increase in salary and pension costs, largely reflecting the effects of the annual pay review and falling interest rates on the cost of providing post-retirement benefits, and the increased cost of agency staff and other contractors which have been offset to an extent by lower severance and related costs following the completion of a number of major restructuring initiatives. Advertising expenditure also increased particularly in the credit card and mortgage businesses and there was wider use of TV advertising; however there was a reduction in the level of operational losses and lower clearings costs. The cost:income ratio deteriorated to 55.3 per cent compared to 53.9 per cent in 2002; however, if the £200 million provision for customer redress is excluded from costs in 2003, the cost:income ratio improved to 51.0 per cent.

Bad debt provisions increased by £98 million to £594 million in 2003 compared to £496 million in 2002 as a result of an increase in the provisions required against the personal lending and credit card portfolios mainly reflecting volume growth during the year but also some deterioration in the arrears levels within the personal loan portfolio and an increase in fraud related losses. There was a net release of £18 million from the provisions held against the mortgage portfolio in 2003 compared to a net release of £1 million in 2002, as the arrears position has improved and the value of the underlying security increased. The provisions charge as a percentage of average lending for personal loans and overdrafts increased to 4.25 per cent in 2003 from 3.73 per cent in 2002, while the charge in the credit card portfolio decreased to 3.19 per cent in 2003 from 3.52 per cent the previous year.

The Lloyds TSB Group s share of the results of its joint venture operations in 2003 was a loss of £22 million compared to £11 million in 2002. Following the purchase by the Lloyds TSB Group of the personal loan and credit card portfolios of Goldfish Bank, the venture began to wind down its remaining business resulting in increased losses from asset write-downs and closure provisions.

Insurance and Investments

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

	2004	2003	2002
	£m	£m	£m
Net interest income	**99**	81	74
Other income	**1,170**	981	1,084
Total income	**1,269**	1,062	1,158
Operating expenses	**(272)**	(261)	(291)
Trading surplus	**997**	801	867
General insurance claims	**(224)**	(236)	(229)
Operating profit	**773**	565	638
Changes in economic assumptions	**(2)**	(22)	55
Investment variance	**147**	125	(943)
Profit (loss) before tax	**918**	668	(250)

Restated, as explained on page 26.

2004 compared to 2003

The operating profit from Insurance and Investments, calculated as explained under Operating and financial review and prospects Line of business information Summary increased by £208 million, or 37 per cent, to £773 million in 2004 compared to £565 million in 2003.

Total income was £207 million, or 19 per cent, higher at £1,269 million compared to £1,062 million in 2003. Net interest income of £99 million was £18 million, or 22 per cent, higher than in 2003 reflecting increased cash balances held within the general insurance businesses.

Other income was £189 million, or 19 per cent, higher at £1,170 million in 2004 compared to £981 million in 2003. Income from long-term assurance business, excluding the effects of changes in economic assumptions and the investment variance, was £165 million higher as a result of improved profitability from new and existing business and a reduced charge in respect of provisions for customer redress (£12 million in 2004 compared to £100 million in 2003). General insurance underwriting premiums were £19 million higher as reduced premiums on the health insurance book, which is being run down, were more than offset by increased income from home contents and asset finance creditor insurance. Reduced levels of retrospective and motor insurance broking commissions lead to a decrease of £18 million in general insurance broking commissions, but improved market conditions lead to increases in asset management income.

Operating expenses were £11 million, or 4 per cent, higher at £272 million in 2004 compared to £261 million in 2003; this reflected higher staff costs, largely as a result of annual pay reviews, and some increase in strategic consultancy spend.

General insurance claims of £224 million in 2004 were down £12 million, or 5 per cent, from £236 million in 2003, reflecting favourable weather conditions.

2003 compared to 2002

The operating profit from Insurance and Investments, calculated as explained under Operating and financial review and prospects Line of business information Summary , fell by £73 million, or 11 per cent, to £565 million from £638 million in 2002.

Total income was £96 million, or 8 per cent lower, at £1,062 million as a £103 million fall in other income more than offset a modest improvement in net interest income of £7 million. Other income was £981 million compared to £1,084 million in 2002. Income from long-term assurance business, excluding the effects of changes in economic assumptions and the investment variance, was £86 million lower. Income from existing business was lower as the benefit from experience variances and actuarial assumption changes reduced by £168 million, reflecting updated assumptions in respect of staff costs to support existing business and benefits recognised in 2002 from changes in the assumed shareholder tax rate and from the valuation of unmodelled products which have not been repeated; the expected return increased by £10 million. There was also a reduction of £61 million in normalised investment earnings reflecting lower market rates of return. This has been partly offset by a £105 million reduction in provisions for customer redress, see Operating and financial review and prospects Risk management Customer treatment risk Customer remediation payments , and by the £41 million increase in new business profitability.

Insurance broking income fell by £43 million reflecting lower levels of creditor insurance and an increased allowance for the clawback of commissions by the insurance underwriters due to the early settlement of loans. There was also a reduction in income from unit trust and asset management activities as a result of lower average fund values and the continued weakness of the long-term savings market. This has been partly offset by a £49 million increase in general insurance premiums as income from the sale of home contents insurance has improved, helped by the buoyant housing market.

Operating expenses decreased by £30 million, or 10 per cent, to £261 million. There was a £42 million reduction in the costs related to the restructuring of the Scottish Widows business and this has more than offset the effect of inflationary increases in other costs.

General insurance claims increased by £7 million to £236 million, as the effect of the increase in the size of the portfolio was largely offset by a reduction in claims caused by the generally mild weather conditions.

Area of business

The operating profit of the life, pensions and unit trust businesses is analysed in the following table. The basis of this analysis is as follows:

The life and pensions results are split into five elements:

- New business income: this represents the value recognised at the end of each financial year from the new business written during that year after taking into account the cost of establishing technical provisions and reserves. This is shown before the significant costs of acquiring that new business, which are shown separately as Distribution costs .
- Distribution costs: the costs of acquiring the new business generated in the year. These comprise the cost of selling products through Lloyds TSB Bank s branch network; the commissions paid to independent financial advisers (IFAs) and related costs of sales through this channel; and the costs of other direct sales channels.
- Existing business: this comprises the following elements:
  - the expected return arising from the unwinding of the discount applied to the expected cash flows at the beginning of a year;
  - experience variances caused by differences between the actual experience during the year and the expected experience;
  - the effects of changes in assumptions, other than economic assumptions, and other items; and
  - provisions for customer redress.
- Development costs: these costs represent the investment made during the year in Sandler products and depolarisation developments, and the development of e-commerce relationships with IFAs.
- Investment earnings: this represents the expected investment return on both the net tangible assets and the value of the shareholder s interest in the long-term business account, based upon the economic assumptions made at the beginning of the year.

Unit trust income is shown before the acquisition costs of new business which are separately disclosed.

	2004	2003	2002
	£m	£m	£m
Life and pensions new business income	**419**	396	313
Life and pensions distribution costs	**(231)**	(241)	(199)
New business contribution	**188**	155	114
Existing business:			
Expected return	**300**	283	273
Experience variances	**(41)**	(16)	(1)
Assumption changes and other items	**(39)**	(75)	78
	220	192	350
Provisions for customer redress	**(12)**	(100)	(205)
Development costs	**(11)**	(13)	
Investment earnings	**167**	153	214
Operating profit (life and pensions)	**552**	387	473
Unit trusts	**75**	62	92
Unit trust distribution costs	**(22)**	(38)	(44)
Profit before tax (unit trusts)	**53**	24	48
Operating profit (life, pensions and unit trusts)	**605**	411	521
General insurance	**160**	153	117

Scottish Widows Investment Partnership	**8**	1	
Operating profit	**773**	565	638
Changes in economic assumptions	**(2)**	(22)	55
Investment variance	**147**	125	(943)
Profit (loss) before tax	**918**	668	(250)
New business margin (life and pensions)	**28.6%**	25.8%	19.2%

Restated, as explained on page 26.

30

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

	2004	2003	2002
	£m	£m	£m
New business premium income and unit trust sales			
Regular premiums	**342.6**	337.9	286.3
Single premiums	**3,141.0**	2,638.3	3,089.0
Unit trusts:			
Regular premiums	**32.6**	41.0	71.5
Single premiums	**538.4**	907.3	1,009.5
Total unit trusts	**571.0**	948.3	1,081.0

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 four main distribution channels for the sale of Lloyds TSB Group s life, pension and unit trust products and the table below shows the relative importance of each.

	2004	2003	2002
	£m	£m	£m
Weighted sales (regular + 1/10 single):			
Life and pensions	**656.7**	601.7	595.2
Unit trusts	**86.4**	131.7	172.4
Life, pensions and unit trusts	**743.1**	733.4	767.6
Weighted sales by distribution channel:			
Branch network	**238.9**	278.8	350.6
Independent financial advisers	**431.6**	391.6	335.4
Direct	**72.2**	61.6	67.9
Other, including International	**0.4**	1.4	13.7
Life, pensions and unit trusts	**743.1**	733.4	767.6

Life, pensions and unit trusts

2004 compared to 2003

Operating profit from life, pensions and unit trusts, calculated as explained under Operating and financial review and prospects Line of business information Summary increased by £194 million, or 47 per cent, to £605 million in 2004 compared to £411 million in 2003; much of this improvement reflected the lower charge in respect of provisions for customer redress of £12 million in 2004, compared to £100 million in 2003. Excluding the charge in respect of provisions for customer redress, operating profit from life, pensions and unit trusts increased by £106 million or 21 per cent to £617 million in 2004 compared to £511 million in 2003.

Within the life and pensions businesses, new business contribution increased by £33 million or 21 per cent to £188 million. New business income was £23 million or 6 per cent higher reflecting a 9 per cent growth in the weighted sales of life and pensions products, driven in particular by higher sales of investment products such as the Flexible Option Bond and the Combination Bond. Distribution costs at £231 million were £10 million lower than in 2003, largely as a result of a change in business mix together with the non-repetition of short-term, fine margin, asset finance related business in the last quarter of 2003. The new business margin, defined as new business contribution divided by weighted sales, was 28.6 per cent compared to 25.8 per cent in 2003.

Regular premium sales of £342.6 million were 1 per cent higher than in 2003 and represented 52 per cent of total weighted sales from life and pensions business, compared to 56 per cent in 2003. Sales of regular premium pensions products were £25.3 million higher, with growth in sales through independent financial advisers and direct channels, as a result of focussed investment in this business and the promotion of specially targeted products more than offsetting a fall in sales through the branch network. Regular life product sales, however, were £18.9 million lower, largely as a result of competitor pricing issues and the impact of some slow down in activity in the mortgage market.

Sales of single premium life and pensions products were £502.7 million, or 19 per cent, higher at £3,141.0 million compared to £2,638.3 million in 2003. There was substantial growth in single premium life sales, reflecting the success of the Combination Bond and the Flexible Option Bond, which have been relaunched and made the subject of increased marketing focus. Sales of annuity products were down due to the decision to withdraw from the with-profits annuity market in 2004, only partly offset by increased sales of the Income Drawdown product. Single premium pension sales were 6 per cent higher, as a result of strong sales of group pension products through the independent financial advisers.

The expected return from existing business was £17 million, or 6 per cent, higher at £300 million compared to £283 million in 2003; the increase reflects the benefit of new business sales by Scottish Widows in 2003 and the effect of the increase in the embedded value discount rate. The impact of experience variances and actuarial assumption changes was a charge of £80 million, £11 million better than the charge of £91 million in 2003; adverse lapse and expense assumption experience being more than offset by the non-repetition of the impact in 2003 of the capitalisation of pension contributions. The charge in respect of provisions for customer redress was significantly lower at £12 million in 2004, compared to £100 million in 2003.

Development costs were £11 million in 2004, compared to £13 million in 2003, and investment earnings were £14 million, or 9 per cent, higher at £167 million in 2004 compared to £153 million in 2003. The increase in investment earnings reflects the increased value of the investment portfolio at the start of 2004 and the increase in the normalised rates of return.

Operating profit from unit trusts increased significantly from £24 million in 2003 to £53 million in 2004 as a result of both an increase in profit before distribution costs and a reduction in distribution costs.

Unit trust profit before distribution costs was £13 million higher at £75 million. Overall weighted sales of unit trust products, at £86.4 million, were £45.3 million, or 34 per cent, lower than the £131.7 million achieved in 2003. Regular premium sales were down 20 per cent at £32.6 million and single premium sales were 41 per cent lower at £538.4 million. The largest decrease in unit trust sales was within the branch network reflecting a change in mix of sales and the reduced number of authorised sellers following a revision of the Lloyds TSB Group s suitability rules. Unit trust sales via independent financial advisers were broadly flat and sales by direct channels increased due to success in retaining customers with maturing products and successful sales of Corporate OEIC s. The fall in sales volumes lead to a reduction in new business income but this was more than offset by an increase in income from existing business, as the improved stock market performance over 2004 has lead to higher fees, together with lower incentive payments and other cost savings. Unit trust distribution costs were £16 million, or 42 per cent, lower at £22 million compared to £38 million in 2003; this decrease reflects, in particular, lower commission payments to the branch network following the sharp fall in sales via that channel.

2003 compared to 2002

The operating profit of the life, pensions and unit trust businesses in 2003 fell by £110 million, or 21 per cent, to £411 million from £521 million in 2003.

New business income increased by £83 million, or 27 per cent, to £396 million. Weighted sales of life and pensions products increased by 1 per cent as sales volumes were affected by weak demand as consumer confidence in long-term savings products remained low. However there was a further change in the product mix towards higher margin regular premium protection policies with the emphasis upon sales of lower margin single premium life products being reduced.

The new business margin, defined as new business contribution divided by weighted sales, improved to 25.8 per cent compared to 19.2 per cent in 2002. The increase in distribution costs was also higher than sales volumes; these costs were up £42 million, or 21 per cent, to £241 million partly reflecting the increase in the proportion of sales made through the comparatively more expensive independent financial adviser channel and also the higher levels of commission payable on sales of the more profitable products.

Regular premium sales amounted to £337.9 million, or 56 per cent of total life and pensions weighted sales, compared to £286.3 million, or 48 per cent of the total in 2002, an increase of £51.6 million. Weighted sales of regular premium pension products increased by £24.0 million as improved sales through the IFA channel, reflecting both Scottish Widows marketing initiatives and investment in this channel, more than offset a reduction in sales through the branch network which have been affected by weak demand. Sales of regular premium life products increased by £27.6 million mainly as a result of higher sales of term assurance and savings products; sales of mortgage-related products providing life cover on repayment mortgages continued to improve, reflecting the buoyant housing market and the resulting strong growth in mortgage lending.

Sales of single premium products fell by £450.7 million, or 15 per cent, from £3,089.0 million in 2002 to £2,638.3 million in 2003. Single premium life product sales decreased by £685.1 million as a result of further reductions in sales of investment bonds due to low stock market values and adverse media comment and the closure of an investment trust in the first half of 2003 due to a lack of suitable quality investment opportunities. This was partly offset by strong growth in single premium pension business; sales rose by £218.9 million or 21 per cent as a result of the improved performance of stakeholder pension products. Sales of single premium annuity business increased by £15.5 million, or 3 per cent, following pricing changes in 2002.

Unit trust sales were £132.7 million, or 12 per cent, lower at £948.3 million compared to £1,081.0 million in 2002 as consumers continued to view investments in equity-based products with caution.

Weighted sales of life, pensions and unit trust products were £733.4 million compared to £767.6 million in 2002. By distribution channel, sales through the branch network fell by £71.8 million, or 20 per cent, to £278.8 million mainly reflecting the significant reductions during 2003 in sales of single premium life and pensions products and unit trusts. Sales of regular premium products were broadly unchanged as initiatives within the branch network resulted in an increase in term assurance sales, which offset a fall in sales of pension products. Branch network sales during 2003 were affected by significant restructuring activity in the personal sector regulated sales force, to reflect lower levels of new business and improved cost efficiency, which resulted in a reduction in its size of almost one third. Direct sales decreased by £6.3 million as a result of lower single premium product sales in difficult market conditions. However, sales through the IFA channel improved by £56.2 million, or 17 per cent, to £391.6 million with particularly strong growth in regular premium products reflecting the benefits of the investment made into this channel in 2002 and earlier. In the 2003 IFA Service Awards, Scottish Widows achieved a five-star rating in all categories.

Existing business profits fell by £158 million, or 45 per cent, to £192 million from £350 million in 2002. Within the expected return a reduction of £39 million reflecting a reduction in the value of in-force business and a lower discount rate was offset by lower restructuring costs in 2003. There was a reduction of £168 million in the benefits from changes in actuarial assumptions and experience variances. It is common practice for life assurance companies to regularly review the detailed assumptions that support the embedded value calculations having regard to recent experience. In 2003 there was a charge of £75 million in respect of actuarial assumption changes compared to a credit of £78 million in 2002, reflecting the capitalisation of pension scheme contributions, following their recommencement in 2003, within the Lloyds TSB Group s embedded value calculations and benefits in 2002 from revisions to the assumed shareholder tax rate and the valuation of unmodelled products which have not been repeated. Experience variances were £15 million worse as a result of a deterioration in lapse and persistency rates.

The decrease in existing business profits was partly offset by a £105 million reduction in the level of additional provisions required for redress payments to customers.

Normalised investment earnings fell by £61 million, or 29 per cent, to £153 million from £214 million in 2002 reflecting a reduction in the expected rates of return in the low interest rate environment in the UK.

Unit trust profits were £24 million compared to £48 million in 2002. Income in the unit trust business is derived from both initial charges at the point of sale and annual management fees which are calculated as a percentage of the unit trust funds. During 2003 unit trust profit before distribution costs fell by 33 per cent following the reduction in weighted average sales, which were 24 per cent lower, and a fall in income reflecting lower annual management charges as the depressed stock markets caused fund values to reduce. Unit trust distribution costs fell by 14 per cent as a result of the fall in sales volumes.

General insurance

	2004	2003	2002
	£m	£m	£m
Premium income from underwriting:			
Creditor	**114**	104	107
Home	**442**	410	350
Health	**27**	43	44
Reinsurance premiums	**(29)**	(22)	(15)
	554	535	486
Commissions from insurance broking:			
Creditor	**377**	351	426
Home	**30**	30	44
Health	**19**	16	17
Other	**160**	207	160
	586	604	647
Operating profit	**160**	153	117
Investment variance	**8**	13	(60)
Profit before tax	**168**	166	57

Restated, as explained on page 26.

2004 compared to 2003

The operating profit, calculated as explained under Operating and financial review and prospects Line of business information Summary from general insurance was £160 million, an increase of £7 million or 5 per cent from £153 million in 2003.

Premium income for underwriting was £19 million, or 4 per cent, higher at £554 million compared to £535 million in 2003. Creditor insurance premiums were 10 per cent higher, as a result of increased sales of the asset finance loan protection products, in part underwritten by the general insurance operations, and home premiums were 8 per cent higher following increases in premium rates and improved retention. Premium income from health insurance decreased from £43 million in 2003 to £27 million in 2004 as a result of the continuing run down of the book. Reinsurance premiums increased by £7 million to £29 million, in part due to growth in the underwritten property business.

Broking commissions decreased by £18 million, or 3 per cent, to £586 million in 2004 compared to £604 million in 2003. Creditor insurance commissions were £26 million higher following renegotiation of rates with external underwriters and an increase in average loan and credit card balances insured; business loan protection income was lower following claw-back adjustments on terminated policies. Home commissions were flat and Health commissions were £3 million higher at £19 million. Other commissions decreased by £47 million to £160 million in 2004 from £207 million in 2003 following a reduction in profit share income from the unusually high levels in 2003.

Investment income was £8 million higher, following increased interest rates as the majority of the investment portfolio is cash based.

Distribution commissions payable to the branch network were largely unchanged; the proportion of sales sourced through the network was lower than in 2003, but this has been largely offset by the passing on of the benefit of improved profit sharing terms agreed with third party underwriters.

General insurance claims, at £224 million, were £12 million, or 5 per cent, lower than £236 million in 2003. Claims on home policies were lower due to the favourable weather conditions in 2004 and health claims have declined as this book is run down. The underwriting claims ratio improved from 42.4 per cent in 2003 to 38.4 per cent in 2004.

2003 compared to 2002

The operating profit from general insurance in 2003 was £153 million, an increase of £36 million, or 31 per cent, compared to 2002.

Premium income from underwriting increased by £49 million, or 10 per cent, to £535 million as a result of continued strong growth in income from the sale of home insurance products which rose by £60 million. An increase in average sums assured has more than offset a decline in sales volumes, particularly through the IFA channel, as commission rates became uncompetitive; sales volumes started to improve in the final quarter of 2003 as commissions payable were increased. Creditor insurance premiums were £3 million lower and reinsurance premiums increased by £7 million due to increased rates in the reinsurance market and higher underwritten premiums.

Commission income from general insurance broking fell by £43 million reflecting a £75 million reduction in income from creditor insurance products as personal loan sales volumes within the branch network started to slow and an allowance of £35 million was made against the clawback of commissions by the insurance underwriters as loans are settled early. Income from sales of home insurance products fell by £14 million due to more competitive offers from other market participants. These factors have been partly offset by a £47 million improvement in other commissions reflecting a significant increase in the level of retrospective commissions receivable from underwriters as the favourable economic conditions have improved the profitability of the policies written.

Investment income was £9 million higher at £54 million, compared to £45 million in 2002.

General insurance claims were £7 million higher at £236 million compared to £229 million in 2002. The claims ratio fell from 45.7 per cent to 42.4 per cent reflecting the beneficial effect of generally mild weather conditions although this did cause an increase in subsidence related claims in the second half of 2003.

Operating expenses and commissions payable to the branch network were £37 million lower overall. The proportion of both underwriting and broking sales sourced through the network was lower in 2003 than in 2004, there were also reductions in advertising and severance costs and these factors more than offset the impact of annual pay reviews.

Changes in economic assumptions

Lloyds TSB Group accounts for the value of the shareholder s interest in the long-term assurance business using the embedded value basis of accounting. The embedded value comprises the net tangible assets of the life assurance subsidiaries and the present value of the in-force business. The present value of the in-force business is calculated by projecting future surpluses and other net cash flows attributable to the shareholder and discounting the result at a rate which reflects the shareholder s overall risk premium.

When projecting future surpluses and other net cash flows Lloyds TSB Group makes a series of assumptions about long-term economic conditions. In order to maintain comparability with other listed insurers in the UK, the Lloyds TSB Group reviews these assumptions at each reporting date.

The economic assumptions have been revised at 31 December 2004 as follows:

	2004	2003	2002
	%	%	%
Risk-adjusted discount rate (net of tax)	**7.40**	7.60	7.35
Return on equities (gross of tax)	**7.17**	7.45	7.10
Return on fixed interest securities (gross of tax)	**4.57**	4.85	4.50
Expenses inflation	**3.76**	3.80	3.30

The revised assumptions have resulted in a net charge to the profit and loss account in 2004 of £2 million (2003: a charge of £22 million).

Investment variance

In accordance with generally accepted accounting practice in the UK, it is Lloyds TSB Group s accounting policy to carry the investments comprising the reserves held by its life companies at market value. The reserves held to support the with-profits business of Scottish Widows are substantial and changes in market values cause significant volatility in the Group s embedded value earnings, which are beyond the control of management. Consequently, in order to provide a clearer representation of the underlying performance, the results of the life and pensions business are separately analysed to show an operating profit including investment earnings calculated using longer-term investment rates of return, and annual management charges based on unsmoothed fund values. The investment variance represents the difference between the actual investment return in the year on investments backing shareholder funds and the expected return based upon the economic assumptions made at the beginning of the year, and the effect of these fluctuations on the value of in-force business. The effects of other changes in economic circumstances beyond the control of management are also reflected in the investment variance. A similar approach has been adopted for Lloyds TSB Group s general insurance business.

In 2004, there was a positive investment variance of £147 million (2003: positive £125 million, 2002: negative £943 million) reflecting increases in stock market values during 2004; the FTSE All-Share index increased by 9 per cent in 2004 compared with a 17 per cent increase in 2003. The benefit of improving stock markets was limited by the lower equities content in the long-term assurance funds and a reduction in the rates of return on fixed interest investments.

35

Wholesale and International Banking

	2004	2003	2002
	£m	£m	£m
Net interest income	**1,966**	1,875	1,970
Other income	**1,641**	1,561	1,520
Total income	**3,607**	3,436	3,490
Operating expenses	**(2,090)**	(2,048)	(1,939)
Trading surplus	**1,517**	1,388	1,551
Provisions for bad and doubtful debts	**(193)**	(306)	(489)
Amounts written off fixed asset investments	**(52)**	(44)	(57)
	1,272	1,038	1,005
(Loss) profit on sale of businesses	**(15)**	865	
Trading results of businesses sold in 2003		318	279
Profit before tax	**1,257**	2,221	1,284
Cost:income ratio*	**57.9%**	59.6%	55.6%
Total assets (year-end)	**£112,968m**	£101,286m	£117,066m
Total risk-weighted assets (year-end)	**£71,143m**	£62,792m	£73,000m

Restated, as explained on page 26.

* Excluding trading results of discontinued operations; see note 2 to the financial statements.

2004 compared to 2003

Profit before tax from Wholesale and International Banking in 2004 was £964 million, or 43 per cent, lower at £1,257 million compared to £2,221 million in 2004. However, comparisons are distorted by the substantial profit on disposal of businesses of £865 million in 2003, compared to a loss of £15 million in 2004 and, in 2003, the trading results of the businesses sold in that year. Adjusting to exclude profits and losses on sale of businesses and the results of discontinued operations, profit before tax in 2004 was £234 million, or 23 per cent, higher at £1,272 million compared to £1,038 million in 2003.

Excluding discontinued operations, net interest income was £91 million, or 5 per cent, higher at £1,966 million compared to £1,875 million in 2003. Average interest-earning assets were £8,095 million higher than in 2003; however much of this increase relates to the growth in fine margin reverse repurchase agreements held for liquidity purposes. Excluding these balances, average interest-earning assets, excluding discontinued operations, were £578 million higher, reflecting growth in Wholesale partly offset by some reductions in the International businesses. Average balances in the asset finance business were £1,314 million higher, as a result of strong lending growth, and corporate lending balances grew by £1,536 million; however, balances, within the Treasury function fell. The net interest margin was 12 basis points lower, again largely reflecting the growth in very fine margin reverse repurchase agreements. Excluding the average reverse repurchase agreement balances from the calculation, the net interest margin was 10 basis points higher reflecting margin widening in corporate banking and asset finance, where lending growth has been in the higher margin consumer portfolios, only partly offset by reductions in business banking where competitive pressures have lead to a tightening of lending margins.

Other income, excluding discontinued operations, was £80 million, or 5 per cent, higher at £1,641 million compared to £1,561 million in 2003. There was a £50 million increase in gains on the sale of assets, largely the realisation of venture capital gains, and improved dealing profits, particularly in respect of currency transactions entered into on behalf of corporate banking customers. Increased activity lead to higher levels of corporate banking lending and other fees and to higher company registration income. Overall operating lease rental income was lower, due to a change in mix towards traditional lending in the asset finance business, and a reduction in income also arose following the rationalisation of the Lloyds TSB Group s motor dealerships in 2003.

Operating expenses, excluding discontinued operations, were £42 million, or 2 per cent, higher at £2,090 million compared to £2,048 million in 2003. Staff costs were higher as a result of business growth, particularly in corporate banking, annual pay awards and higher levels of performance related bonuses. Operating lease depreciation was £45 million lower, as a result of the change in mix of business in asset finance, and there were cost reductions following the rationalisation of the Lloyds TSB Group s motor dealerships.

Provisions for bad and doubtful debts, excluding discontinued operations, were £113 million, or 37 per cent, lower at £193 million compared to £306 million in 2003. The charge within the asset finance operations increased in line with business volumes but this was more than offset by a reduction in corporate banking, where the improved business environment lead to several large releases, and in International following the release of £30 million from the general provision that was held in relation to the Lloyds TSB Group s exposures in Argentina.

Amounts written off fixed asset investments were £8 million, or 18 per cent, higher at £52 million compared to £44 million in 2003 as a result of growth in the venture capital portfolio.

2003 compared to 2002

The profit before tax of Wholesale and International Banking increased by £937 million to £2,221 million in 2003 including a profit on the disposal of businesses in New Zealand, Brazil and France of £865 million. If this gain and the trading results of the businesses disposed of in 2003 are excluded there was an underlying improvement in profit from continuing operations of £33 million to £1,038 million.

Total income from continuing operations decreased by £54 million to £3,436 million. Net interest income fell by £95 million to £1,875 million. Within the Wholesale businesses net interest income fell by £74 million reflecting the implementation of the Competition Commission s SME report remedies: the provision of interest-bearing current accounts to small business customers has caused the margin to fall by 24 basis points, reducing net interest income by £169 million. There was also lower income from treasury activities as the interest rate cut in the early part of 2003 and flattening of the yield curve reduced market opportunities. This more than offset the effects of strong growth within the asset finance operations which resulted in an increase in net interest income of £99 million; average asset finance balances increased by £991 million, mainly due to the continued demand for consumer credit in the UK, and the margin widened by 48 basis points. There was also an increase in income from structured finance transactions following the growth in balances during 2002. In International Banking there was a decrease in net interest income from continuing operations of £21 million; net interest income fell as balances were reduced, particularly in Latin America, as the Lloyds TSB Group sought to reduce its exposure to these economies.

Other income from continuing operations increased by £41 million, or 3 per cent, to £1,561 million as a result of a £105 million increase within Wholesale. This principally reflected the inclusion of income from the sale of cars by the Dutton-Forshaw Group following its acquisition in December 2002, increasing income by £51 million, and gains of £34 million on the sale of a number of leases by Lloyds TSB Leasing where the tax attributes could be used by the purchasers. There were also increases in the level of gains realised on the sale of venture capital investments and fees from corporate, asset finance and factoring activity; however, this was partly offset by a £36 million increase in commissions paid to motor dealers by the asset finance operation, reflecting the growth in levels of new business, and lower income from company registration activities. In International Banking, other income from continuing operations fell by £64 million mainly as a result of a £28 million reduction in profits from the sale and leaseback of premises. There was also a reduction in fund management fees and lower income from Argentina as the level of activity was reduced.

Operating expenses from continuing operations increased by £109 million or 6 per cent. In Wholesale there was an increase of £110 million; the inclusion of the Dutton-Forshaw Group accounted for £44 million of this increase. Within Corporate Banking there was a £39 million increase in costs. Operating lease depreciation increased by £19 million as an accelerated charge was recorded following the reassessment of the carrying value of a small number of operating lease assets and there were higher staff and risk management costs, although this was partly offset by lower reorganisation costs. There were smaller increases in other areas of Wholesale principally relating to staff and consultancy costs to support a number of major projects. In International Banking operating expenses from continuing operations reduced by £1 million.

The provisions charge from continuing operations fell by £183 million to £306 million. The charge within Wholesale fell by £78 million as the level of new provisions required against corporate customers reduced. In 2002 provisions totalling some £100 million were made against large US exposures which were not repeated to the same extent during 2003. In the asset finance business the provisions charge was largely unchanged despite strong lending growth during 2003, as the high level of voluntary terminations experienced in 2002 were not repeated during 2003. Within International Banking the charge from continuing operations fell by £105 million mainly as a result of a reduction of £79 million in the new provisions required against the Lloyds TSB Group s exposures in Argentina as the economic conditions in that country started to stabilise. There was also a reduction in the charge in other Latin American operations as specific cases requiring provisions in 2002 were not repeated.

Amounts written off fixed asset investments fell by £13 million to £44 million reflecting lower charges against both corporate and venture capital investments.

In 2003, a profit of £865 million arose on the sale of The National Bank of New Zealand, substantially all of Lloyds TSB Group s businesses in Brazil and its French fund management and private banking businesses. The trading profits of those businesses, the discontinued operations, in 2003 were £39 million or 14 per cent higher at £318 million, compared to £279 million in 2002, as a result of a £46 million increase in income (particularly reflecting volume growth and favourable exchange rate movements in New Zealand, more than offsetting some margin erosion) coupled with a £5 million reduction in operating expenses; these favourable movements more than offset a £12 million increase in bad debt provisions.

Central group items	**2004**	2003	2002
	£m	£m	£m
Accrual for payment to Lloyds TSB Foundations	**(31)**	(31)	(33)
Other finance income	**39**	34	165
Funding cost of acquisitions less earnings on capital	**(342)**	(345)	(317)
Profit on sale of emerging markets debt portfolio and certain closed foreign exchange positions		295	212
Central costs and other unallocated items	**1**	35	9
	(333)	(12)	36

Restated, as explained on page 26.

2004 compared to 2003

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 the dividend on their shareholdings. In 2004, the Lloyds TSB Group accrued £31 million (2003: £31 million) for payment to the Lloyds TSB Foundations. See note 40 to the financial statements.

Other finance income represents income from the expected return on the Lloyds TSB Group s pension fund assets after a charge for the unwinding of the discount on the pension fund liabilities; the increase of £5 million, from £34 million in 2003 to £39 million in 2004, represents a £68 million increase in the expected return on assets, as a result of improved market levels at the end of 2003, largely offset by a £63 million increase in the interest cost, reflecting the increase in liabilities over 2003.

Lloyds TSB Group s remaining portfolio of emerging markets debt securities was sold in 2003 and so the profits on these bond sales, and certain closed foreign exchange positions, of £295 million in 2003 were not repeated in 2004.

2003 compared to 2002

In 2003, the Lloyds TSB Group accrued £31 million for payment to the Lloyds TSB Foundations, a reduction of £2 million compared to 2002. Although there was a recovery in profitability during 2003 after making adjustment for disposal gains, there was a fall in the three year rolling average reducing the amount payable.

The significant reduction in other finance income in 2003 compared to 2002 reflected the combined impact of a reduction in the expected return on lower pension scheme assets as a result of a continuing weakness in global equity markets, and increased pension fund liabilities at the beginning of 2003.

During the first half of 2003 improved secondary bond market conditions allowed the Lloyds TSB Group to sell its portfolio of emerging markets debt securities. Profits on bond sales, and certain closed foreign exchange positions, in 2003 totalled £295 million compared to £212 million in 2002. This benefit was partly offset by lower earnings on the investment of the Lloyds TSB Group s capital reflecting the reduction in average UK interest rates over 2003 compared to 2002.

Future accounting developments

International Financial Reporting Standards (IFRS)

Up to 31 December 2004, the Lloyds TSB Group prepared its financial statements in accordance with UK Generally Accepted Accounting Principles (UK GAAP). On 1 January 2005, the Lloyds TSB Group, in common with other listed entities within the European Union (EU), implemented IFRS. In addition, in accordance with an undertaking given to the UK Accounting Standards Board during 2004, the Lloyds TSB Group has adopted the requirements of FRS 27 which has the effect of changing the accounting for certain insurance contracts in the Lloyds TSB Group s life assurance business. The impact of these changes is outlined below and is based on the transition information released by the Lloyds TSB Group on 27 May 2005 which sets out, in further detail, the key impacts of the anticipated financial changes on particular line items in the financial statements.

2004 impact

In accordance with the requirements of IFRS, revised results for 2004 include only those adjustments for standards implemented with effect from 1 January 2004 (i.e. they exclude adjustments for standards which have been implemented with effect from 1 January 2005 which are outlined in a separate section below).

The following table sets out the impact for 2004.

Area of impact	IFRS treatment
Consolidation	IFRS requires line-by-line consolidation for all subsidiaries. Consequently, the Lloyds TSB Group is no longer permitted to report the results and balances of the life assurance business on one line; instead these amounts must be broken down into their constituent parts and allocated to the appropriate line items. IFRS also requires consolidation of several entities that the Lloyds TSB Group was not required to consolidate under UK GAAP. These relate to the entities supporting the Lloyds TSB Group s securitisation conduits, which facilitate customers own securitisations, and to Open Ended Investment Companies (OEICs) where the Lloyds TSB Group, through the Scottish Widows life funds, has an interest. This will have the effect of grossing-up the balances reported in the income statement and on the balance sheet. These changes have reduced the Lloyds TSB Group s profit before tax for the year ended 31 December 2004 by £4 million and increased shareholders equity at 31 December 2004 by £13 million.
Leasing	IFRS requires income from finance leases to be credited to the income statement so as to give a constant pre-tax rate of return on the net cash invested; UK GAAP requires a constant post-tax rate of return. In addition, IFRS requires depreciation on operating lease assets to be charged on the same basis as for tangible fixed assets which for the Lloyds TSB Group is a straight-line basis. Under UK GAAP depreciation is charged so as to give a constant rate of return on the leased asset. The effect of these changes is to reduce profit before tax for the year ended 31 December 2004 by £32 million and reduce shareholders equity at 31 December 2004 by £268 million.
Employee benefits	IFRS 2 requires that a cost be recognised in the financial statements for all options granted under executive and employee Save-As-You-Earn share option schemes. The total cost recognised represents the fair value of the options (as determined using an option valuation model) at the grant date, as adjusted for the expected number of forfeitures and, for executive schemes, the probability that the performance target will not be met. This total cost is spread over the period to vesting. This will result in an increase in the costs recognised in the Lloyds TSB Group s income statement as under UK GAAP only the intrinsic value of executive share options is charged to the profit and loss account. The Lloyds TSB Group has applied the requirements of FRS 17, *Retirement Benefits*, in its UK GAAP financial statements since 2002. The requirements of that standard are broadly similar to those of IAS 19, *Employee Benefits*; the application of IAS 19 has therefore had no significant impact on the Lloyds TSB Group s profit before tax for the year ended 31 December 2004. The Lloyds TSB Group has elected to apply the corridor approach to determine the treatment of actuarial gains and losses arising during the year as permitted under IAS 19. This means that 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. If the cumulative gains or losses exceed the corridor, the excess is charged or credited to the income statement on a straight-line basis over the average remaining service lives of those employees who are members of the schemes. The effect of this has been to derecognise the actuarial losses charged to reserves in 2004 under UK GAAP in the restated figures. The overall effect of the changes in accounting for employee benefits is to reduce profit before tax for the year ended 31 December 2004 by £25 million, principally representing the additional cost of the Lloyds TSB Group s SAYE share option schemes. Shareholders equity at 31 December

2004 increased by £95 million largely as a result of the reversal of the actuarial losses charged against reserves in 2004 under UK GAAP.

Area of impact	IFRS treatment
Capitalisation of software	Currently only software costs relating to separable new systems are capitalised. Under IFRS, costs relating to enhancements that lead to additional system functionality will also be capitalised. The impact on the Lloyds TSB Group s income statement will depend on the level of IT expenditure and whether it meets the criteria for capitalisation. The effect of this change is to reduce profit before tax for the year ended 31 December 2004 by £12 million (the effect of additional software capitalised during the year under IFRS is more than offset by an increased amortisation charge reflecting the impact of additional software capitalised as at 1 January 2004). Shareholders equity at 31 December 2004 is increased by £19 million equivalent to the post-tax value of the additional software capitalised at that date.
Investment management fees	Under IFRS the Lloyds TSB Group will move from immediate recognition of up-front fees received for investment management services to recognising them on a straight-line basis over the estimated lives of the investment contracts. The effect of this change has been to increase the Lloyds TSB Group s profit before tax for the year ended 31 December 2004 by £31 million. Shareholders equity at 31 December 2004 is reduced by £37 million.
Goodwill	The current Lloyds TSB Group policy of amortising goodwill arising on acquisitions after 1 January 1998, with the exception of the goodwill which arose on the acquisition of Scottish Widows, will cease. Instead, all goodwill will be subject to impairment testing annually, or more frequently if events or circumstances indicate that it might be impaired. The effect of this change is to increase profit before tax for the year ended 31 December 2004 by £44 million and shareholders equity at 31 December 2004 by £41 million.
Dividends	Under IFRS equity dividends declared after the balance sheet date may not be included as a liability at the balance sheet date. The effect of this change is to increase shareholders equity at 31 December 2004 by £1,315 million, the amount of the 2004 final dividend.
Depreciation	In addition to the impact for depreciation of operating lease assets outlined above, IFRS requires property, plant and equipment to be depreciated since the date of acquisition. Under UK GAAP, long leasehold and freehold properties have been depreciated only since 1 January 2000 and therefore it is necessary to adjust their carrying values to reflect the depreciation that would have been charged from the date of acquisition to 1 January 2000. The effect of this change is to reduce shareholders equity at 31 December 2004 by £47 million; the impact on the Lloyds TSB Group s profit before tax for the year ended 31 December 2004 is not significant.
Claims equalisation provision	The claims equalisation provision in respect of the Lloyds TSB Group s general insurance business, established under law to minimise volatility in incurred claims, is not permitted under IFRS. The effect of this change has been to increase the Lloyds TSB Group s profit before tax for the year ended 31 December 2004 by £10 million. Shareholders equity at 31 December 2004 increased by £43 million.

The most significant changes for 2004 arising from the transition to those IFRS standards which apply from 1 January 2004 are the different accounting treatment of goodwill, leasing, employee share option schemes and certain aspects relating to the Lloyds TSB Group s insurance businesses. These changes have had the effect of increasing profit before tax for the year ended 31 December 2004 by £2 million to £3,495 million and shareholders equity at 31 December 2004 by £1,173 million to £11,150 million.

1 January 2005 opening balance sheet impact

The following table sets out the impact of those standards that are applied from 1 January 2005 including FRS 27.

Area of impact	IFRS treatment
Fees integral to effective yield	Fees and commissions that are an integral part of the effective yield on a financial instrument, and direct incremental costs associated with its origination, are included in the calculation of the effective interest rate and recognised over the expected life of the instrument, or a shorter period if appropriate. The effective interest rate is the rate that exactly discounts the expected future cash receipts or payments over the expected life of the financial instrument to the net carrying value of the instrument. As a result, up-front fees and costs that were recognised when received, or incurred, under UK GAAP, for example those related to loan origination, are now deferred; and fee income typically charged at the end of an agreement, for example early redemption charges on mortgages, is now brought forward. The effect of this change has been to increase shareholders equity at 1 January 2005 by £22 million.

Area of impact	IFRS treatment
Loan impairment	IFRS adopts an incurred loss model for impairment losses on loans and provides guidance on the measurement of impairment. A provision is raised for losses in respect of exposures that are known to be impaired. The required provision is calculated by comparing the book value of the loans with the net present value of the expected future cash flows from the loans discounted at their effective interest rates or, as a practical expedient for variable rate loans, using observable market prices. Exposures found not to be impaired are placed into pools of similar assets with similar risk characteristics to be collectively assessed for losses that have been incurred, but are not yet identified. For such exposures, the required provision is estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the collective pool, adjusted based on current observable data. As the discounting effect on the provisions unwinds, the resulting income is reflected within net interest income. Although many of these principles are similar to those followed by the Lloyds TSB Group under UK GAAP, the requirement to discount the expected cash flows at the original effective interest rate when determining the provisioning requirement has resulted in an increase in provisions of £314 million at 1 January 2005, which, after tax, has resulted in a reduction in shareholders equity of £221 million. This is not a reflection of any change in credit quality as there has been no change in the level of expected cash recoveries.
Netting	IFRS prohibits financial assets and financial liabilities from being offset unless there is a legal right of set-off and the asset and liability are in practice normally settled on a net basis. In the banking business, this will result in the grossing-up on the balance sheet of certain assets and liabilities subject to set-off arrangements that were presented net under UK GAAP. As a result of this change, at 1 January 2005 balance sheet footings have been increased by £10,243 million principally reflecting the grossing up of corporate loans and deposits and inter-bank derivative balances, which although subject to set-off arrangements, will not be settled on a net basis.
Derivatives, hedging and investment securities	The Lloyds TSB Group enters into derivative contracts for both trading purposes and to hedge exposures arising from within the banking book. Under UK GAAP trading derivatives were carried at fair value but hedging derivatives were accounted for on the same basis as the underlying hedged item, mainly on an accruals basis. IAS 39 requires that all derivative contracts are carried at fair value on the Lloyds TSB Group s balance sheet and movements in their fair value are reflected in the income statement; this results in a mismatch between the accounting and the underlying economics where the Lloyds TSB Group has hedged its economic risk resulting from the different treatment of the derivative and the underlying hedged position. The Lloyds TSB Group has not changed the way it hedges its economic exposures as a result of the implementation of IFRS, but the Lloyds TSB Group seeks to mitigate the resulting income statement volatility by the application of hedge accounting. The Lloyds TSB Group uses two of the permitted kinds of hedge accounting: fair value and cash flow hedge accounting. The Lloyds TSB Group makes greater use of fair value hedge accounting which seeks to match, in the income statement, changes in the fair value of the hedged risk with the changes in the fair value of the related derivatives. Cash flow hedge accounting is being used to a lesser extent; adjustments reflecting the movements in the fair values of the derivatives concerned are made to a separate reserve in equity and recycled to the income statement when the hedged cash flows affect income. IFRS contains detailed requirements for designation and documentation of hedge relationships and testing of their effectiveness. To the extent that a hedge is ineffective, the impact is immediately reflected in the income statement. Although the Lloyds TSB Group intends to mitigate the volatility arising from the requirement to fair value all derivatives as far as possible, this will be a source of increased volatility in the income statement in 2005 and beyond. An adjustment has been made at 1 January 2005 to measure all derivatives at their fair value and to reflect the establishment as at that date of compliant hedging relationships. The overall effect has been to reduce shareholders equity by £192 million. Under UK GAAP debt securities held for continuing use in the business were classified as investment securities and carried in the balance sheet at cost less any provisions for permanent diminution in value. IAS 39 introduces strict requirements to be met before debt securities can be carried at amortised cost and the Lloyds TSB Group has determined that it does not meet these. Accordingly debt securities previously classified as investment securities have been reclassified as available-for-sale and valued at their fair values at 1 January 2005. Equity shares may not be carried at cost under IAS 39 and these have also been reclassified as available-for-sale. The effect of this reclassification has been to increase shareholders equity at 1 January 2005 by £28 million. Going forward, movements in the fair values of these available-for-sale securities will be reflected in equity and the cumulative gain or loss recycled through the income statement upon disposal or impairment.

Area of impact	IFRS treatment
Insurance	IFRS 4, which introduces a revised definition of an insurance contract, applies to insurance contracts as well as investment contracts with discretionary participation features. Such investment contracts entitle the holder to receive additional discretionary benefits (bonuses) depending on performance and are referred to as participating investment contracts. Investment contracts that are not within the scope of IFRS 4 are accounted for as financial instruments under IAS 39. The principal effects of this change on the accounting for non-participating investment contracts is the removal of that portion of the embedded value which represents the value of in-force business relating to those contracts, the recognition of an asset for deferred acquisition costs, and the deferral of up-front fees received for investment management services; deferred acquisition costs and deferred up-front fees are amortised over the period of the provision of investment management services. For those contracts within the scope of IFRS 4, accounting practices are largely unchanged except for the modifications introduced by FRS 27 which is dealt with separately below. The effect of this change is to reduce shareholders equity at 1 January 2005 by £836 million.
Life assurance (FRS 27)	Following the implementation of FRS 27, the Lloyds TSB Group excludes from the value of in-force business recognised in the balance sheet any amounts that reflect future investment margins and measures the liabilities of the Scottish Widows With-Profits Fund in accordance with the realistic capital regime of the Financial Services Authority. This basis includes a realistic valuation of guarantees and options embedded within products written by the With-Profits Fund. The principal effect of these new requirements is on the measurement of the in-force business, as the valuation of the With-Profits Fund on a realistic basis reduces the expected income to the shareholder from that fund. Changes in the valuation are reflected in the income statement and because this is market related it is inherently volatile. The effect of these changes has been to reduce shareholders equity at 1 January 2005 by £230 million.
Equity to debt reclassification	The classification of the majority of the Lloyds TSB Group s capital and subordinated debt instruments will continue to follow their UK GAAP treatment; however, the limited voting ordinary shares will be reclassified as debt. This is because under the terms of the agreement with the four Lloyds TSB Foundations, which are the holders of the limited voting ordinary shares, the Lloyds TSB Group is committed to making an annual payment, equivalent to 1 per cent of the consolidated pre-tax profit, averaged over three years. In addition, the Lloyds TSB Group s preferred securities, which were treated as non-equity minority interests under UK GAAP, will be reclassified as debt because the coupon payment is not discretionary. Distributions on these securities will be shown as interest expense rather than as minority interests. The effect of these reclassifications is to reduce shareholders equity by £20 million and minority interests by £550 million at 1 January 2005; long-term borrowings increase by £570 million.
Derecognition of financial liabilities	Under IFRS a financial liability may only be removed from the balance sheet after it has been settled, it has expired or alternatively the debtor has been legally released from the liability, either by process of law or by the creditor. Upon adoption of IFRS, certain financial liabilities in respect of which amounts had been released to the profit and loss account under UK GAAP on the basis that the likelihood of their settlement was remote have been remeasured as at 1 January 2005 to reflect the entire legal obligation. At 1 January 2005 the effect of the remeasurement is to increase liabilities by £184 million which, after tax, has resulted in a reduction in shareholders equity of £131 million.

The most significant changes arising from the transition to IFRS and FRS 27 are in relation to life assurance and dividend accounting; and the grossing up of certain lending, deposit and derivative balances. In overall terms, the impact of adopting IFRS and FRS27 (including the impact of changes for 2004 outlined above) on the Lloyds TSB Group s shareholders equity at 31 December 2004 was to reduce the UK GAAP balance of £9,977 million by £405 million to £9,572 million.

Future impact

The effect of the full implementation of IFRS and FRS27 on the Lloyds TSB Group s 2005 earnings will depend upon a number of factors such as business mix, rate of growth and market conditions. The increased use in IFRS of fair values is likely to lead to greater volatility, particularly in the results of the Lloyds TSB Group s life assurance businesses. Excluding this volatility, the application of effective interest rates, the reclassification of certain securities from equity to debt and the impact of discounting on levels of loan loss impairment are likely to result in some reduction in profits.

Current indications are that the overall impact, excluding the volatility introduced by the requirements of IFRS and FRS 27, will be to reduce the Lloyds TSB Group s reported earnings per share, compared with those that would have been reported under UK GAAP, by approximately 6 per cent. Excluding goodwill amortisation, earnings per share (before volatility) are expected to reduce by approximately 7 per cent. Profit before tax (before volatility) is expected to be approximately 8 per cent lower, additionally reflecting the inclusion of coupon payments on preferred securities now being treated as an interest expense rather than minority interests. This likely reduction in earnings in 2005 is almost entirely due to changes in the timing of income and expense recognition in the Lloyds TSB Group s financial statements.

Further standards and interpretations may be issued that could be applicable for financial years ending in 2005 or later accounting periods but with the option for earlier adoption. IFRS is also being applied in the EU and other countries for the first time and practice on which to draw in applying the standards is still developing. Consequently, the overall impact of IFRS on the Lloyds TSB Group s results and financial position is subject to change.

UK GAAP compared with US GAAP

Under US GAAP, Lloyds TSB Group s net income for the year ended 31 December 2004 was £1,508 million (2003: £3,231 million) compared to £2,421 million (2003: £3,254 million) under UK GAAP. Reconciliations between UK GAAP and US GAAP figures, together with detailed explanations of the accounting differences, are included in note 50 to the financial statements.

As was the case under UK GAAP, the decline in the Lloyds TSB Group s US GAAP net income in 2004 compared to 2003 primarily reflects the non-recurrence of the gains on the disposal of a number of overseas businesses, principally The National Bank of New Zealand. The 2004 US GAAP results have also been adversely affected by the implementation of the requirements of AICPA Statement of Position 03-1, which has changed the way in which certain aspects of the Group s insurance business are accounted for, and resulted in a charge to reflect the cumulative effect of the change in accounting principle. In addition, the implementation of the requirements of FIN 46(R) in 2004, has resulted in certain additional entities being consolidated into the 2004 US GAAP results; this has had the effect of reducing net income in 2004.

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 UK GAAP applicable to banking groups, life assurance activities are accounted for using the embedded value basis of accounting which requires the recognition of the discounted value of the projected future net cash flows attributable to the shareholder at the point of sale. UK GAAP therefore results in a substantial proportion of the net profit accruing on a portfolio of life assurance policies being recognised at their inception. Under US GAAP income is recognised in the profit and loss account 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.

Goodwill and intangible assets. Under US GAAP, goodwill is not amortised through the profit and loss account. Goodwill is amortised under UK GAAP, however the charge in the Lloyds TSB Group s profit and loss account is relatively small since the directors have decided that it is not appropriate to amortise the goodwill that arose on the acquisition of Scottish Widows in 2000. This is therefore not a cause of a significant difference in net income. However, under US GAAP, the Lloyds TSB Group is required to recognise an intangible asset reflecting the value of the customer relationships associated with acquisitions made in prior periods. This intangible asset is amortised through the profit and loss account reducing US GAAP net income.

Derivatives. Under UK GAAP, derivatives held for risk management purposes are accounted for on an accruals basis, in line with the underlying instruments being hedged. 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 UK GAAP this means that net income and shareholders equity under US GAAP are subject to greater volatility.

Pensions. Under UK GAAP actuarial gains and losses arising from the Group s pension schemes are adjusted against reserves in the year in which they arise. Under US GAAP actuarial gains and losses are not recognised unless the cumulative effect exceeds 10 per cent of the greater of the projected benefit obligation or the value of the plan assets; in these circumstances the excess is amortised through the profit and loss account over the average remaining service lives of active employees.

At the beginning of the year the cumulative unrecognised actuarial losses related to the Lloyds TSB Group s pension schemes exceeded the prescribed limits and consequently the 2004 US GAAP results include an amortisation charge which is not recognised under UK GAAP.

Average balance sheet and net interest income

The following average balance sheet 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, particularly in 2003 and earlier years. The countries in which Lloyds TSB Group has operated are periodically subject to comparatively high rates of interest, which in certain instances in the tables below has had the effect of producing unusually high yields and costs.

	2004 Average balance £m	**2004 Interest income £m**	**2004 Yield %**	2003 Average balance £m	2003 Interest income £m	2003 Yield %	2002 Average balance £m	2002 Interest income £m	2002 Yield %
Assets									
Treasury bills and other eligible bills:									
Domestic offices	**41**	**2**	**4.88**	2,237	68	3.04	2,608	85	3.26
Foreign offices	**161**	**4**	**2.48**	541	5	0.92	906	211	23.29
Loans and advances to banks:									
Domestic offices	**19,289**	**578**	**3.00**	11,831	412	3.48	11,839	470	3.97
Foreign offices	**2,071**	**62**	**2.99**	2,487	117	4.70	2,275	129	5.67
Loans and advances to customers:									
Domestic offices	**126,573**	**8,243**	**6.51**	111,340	6,877	6.18	100,087	6,494	6.49
Foreign offices	**5,514**	**219**	**3.97**	18,491	1,434	7.76	17,695	1,761	9.95
Debt securities:									
Domestic offices	**9,842**	**305**	**3.10**	9,863	350	3.55	8,661	347	4.01
Foreign offices	**4,372**	**118**	**2.70**	4,664	102	2.19	6,022	220	3.65
Lease and hire purchase receivables:									
Domestic offices	**11,118**	**864**	**7.77**	11,429	783	6.85	11,707	830	7.09
Foreign offices				13	1	7.69	18	2	11.11
Total interest-earning assets of banking book	**178,981**	**10,395**	**5.81**	172,896	10,149	5.87	161,818	10,549	6.52
Total interest-earning assets of trading book	**14,992**	**589**	**3.93**	17,622	666	3.78	15,518	602	3.88
Total interest-earning assets	**193,973**	**10,984**	**5.66**	190,518	10,815	5.68	177,336	11,151	6.29
Provisions for bad and doubtful debts	**(1,729)**			(1,846)			(1,623)		
Non-interest earning assets:									
Domestic offices	**19,967**			18,973			19,941		
Foreign offices	**902**			3,353			2,822		
Total average assets and interest income	**213,113**	**10,984**	**5.15**	210,998	10,815	5.13	198,476	11,151	5.62
Percentage of assets applicable to foreign activities (%)	**6.0**			13.8			14.8		

	2004 Average interest earning assets £m	**2004 Net interest income £m**	**2004 Net interest margin %**	2003 Average interest earning assets £m	2003 Net interest income £m	2003 Net interest margin %	2002 Average interest earning assets £m	2002 Net interest income £m	2002 Net interest margin %
Average interest-earning assets and net interest income:									

Banking business	**178,981**	**4,920**	**2.75**	172,896	5,255	3.04	161,818	5,171	3.20
Trading business	**14,992**			17,622			15,518		
Net yield on interest-earning assets	**193,973**	**4,920**	**2.54**	190,518	5,255	2.76	177,336	5,171	2.92

	2004 Average balance £m	**2004 Interest expense £m**	**2004 Cost %**	2003 Average balance £m	2003 Interest expense £m	2003 Cost %	2002 Average balance £m	2002 Interest expense £m	2002 Cost %
Liabilities and shareholders funds									
Deposits by banks:									
Domestic offices	**20,199**	**456**	**2.26**	13,610	259	1.90	12,587	322	2.56
Foreign offices	**4,227**	**102**	**2.41**	5,333	113	2.12	4,234	137	3.24
Liabilities to banks under sale and repurchase agreements:									
Domestic offices	**4,200**	**192**	**4.57**	1,449	29	2.00	2,799	80	2.86
Foreign offices	**4**		**2.41**	253	37	14.62	457	77	16.85
Customer accounts:									
Domestic offices	**105,926**	**3,044**	**2.87**	97,864	2,282	2.33	83,529	2,240	2.68
Foreign offices	**2,303**	**40**	**1.74**	8,637	450	5.21	11,265	993	8.81
Liabilities to customers under sale and repurchase agreements:									
Domestic offices	**2,787**	**125**	**4.49**	2,990	148	4.95	2,898	135	4.66
Foreign offices	**121**	**2**	**1.65**	156	3	1.92	140	4	2.86
Debt securities in issue:									
Domestic offices	**18,389**	**865**	**4.70**	16,793	606	3.61	14,750	498	3.38
Foreign offices	**2,685**	**48**	**1.79**	7,959	345	4.33	7,953	355	4.46
Subordinated liabilities:									
Domestic offices	**10,175**	**601**	**5.91**	10,371	610	5.88	9,401	526	5.60
Foreign offices				198	12	6.06	190	11	5.79
Total interest-bearing liabilities of banking book	**171,016**	**5,475**	**3.20**	165,613	4,894	2.96	150,203	5,378	3.58
Total interest-bearing liabilities of trading book	**14,992**	**589**	**3.93**	17,622	666	3.78	15,518	602	3.88
Total interest-bearing liabilities	**186,008**	**6,064**	**3.26**	183,235	5,560	3.03	165,721	5,980	3.61
Interest-free liabilities									
Minority interests and shareholders funds:									
Domestic offices	**8,208**			6,133			8,522		
Foreign offices	**2,388**			3,064			2,801		
Non-interest bearing customer accounts:									
Domestic offices	**3,134**			2,745			5,985		
Foreign offices	**373**			845			789		
Other interest-free liabilities:									
Domestic offices	**12,252**			12,282			13,118		
Foreign offices	**750**			2,694			1,540		
Total average liabilities and interest expense	**213,113**	**6,064**	**2.85**	210,998	5,560	2.64	198,476	5,980	3.01
Percentage of liabilities applicable to foreign activities (%)	**5.2**			12.9			14.2		

Net interest margin for the banking book

	2004 %	2003 %	2002 %