Taxation

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

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

Economic profit

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

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

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

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

	2005 £m	2004 £m
Average shareholders' equity	**9,747**	10,493
Profit attributable to equity shareholders	**2,493**	2,392
Less: notional charge	**(877)**	(944)
Economic profit	**1,616**	1,448

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

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

Line of business information

Summary

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

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

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

UK Retail Banking

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

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

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

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

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

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

Impairment losses on loans and advances, at £1,111 million, were £435 million or 64 per cent higher than 2004. The impact of the accounting standards applied with effect from 1 January 2005 accounted for £206 million of this increase; excluding this underlying impairment losses were £229 million, or 34 per cent, higher at £905 million in 2005. The charge in respect of personal loans, overdrafts and credit cards increased as a result of volume growth over recent years as well as some deterioration in credit quality as increasing numbers of customers, with higher levels of indebtedness, are experiencing repayment difficulties. Within the mortgage business there continued to be a low level of losses and as a result the impairment charge was £13 million, compared to a release of £39 million in 2004. Cheltenham & Gloucester (C&G) continued to focus on prime lending market segments during 2005. The average indexed loan-to-value ratio for C&G new mortgages and further advances written during 2005 was 64 per cent. At 31 December 2005, 95 per cent of C&G mortgage balances had an indexed loan-to-value ratio of less than 85 per cent and only 0.6 per cent of balances had an indexed loan-to-value ratio in excess of 95 per cent.

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

Insurance and Investments

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

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

2005 compared to 2004

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

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

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

The increase in premium income and trading income are largely offset by a matching increase in insurance claims, reflecting the fact that the majority of the premium inflows and investment gains are for the benefit of policyholders. Insurance claims were £2,564 million, or 27 per cent, higher at £12,186 million in 2005 compared to £9,622 million in 2004. If the 1 January 2005 reclassifications to investment contracts, described above, are excluded underlying insurance claims were £5,172 million, or 54 per cent, higher at £14,794 million in 2005, compared to £9,622 million in 2004.

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

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

Life, pensions and OEICs

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

	2005 **£m**	2004 £m
New business and OEIC sales		
Regular premiums	**356**	343
Single premiums	**3,982**	3,141
OEIC's		
– Regular premiums	**33**	33
– Single premiums	**1,148**	538
Total OEIC's	**1,181**	571

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

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

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

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

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

Profit before tax, excluding volatility, from life, pensions and OEICs was £98 million, or 16 per cent, lower at £500 million compared to £598 million in 2004. Profitability in 2005 benefited from the absence of a provision for customer redress but the results in 2005 were reduced by a provision of £155 million for the strengthening of mortality reserves. Adjusting for these items, profit before tax, excluding volatility, in 2005 was £655 million compared to £610 million in 2004, an increase of £45 million or 7 per cent. The strong sales lead to an increased contribution from new business, partly offset by a commensurate increase in distribution costs. Improved investment earnings resulted from higher cash balances held for the account of the shareholder. OEICs profitability has risen following improved markets and sales volumes.

General insurance

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

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

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

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

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

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

Wholesale and International Banking

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

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

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

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

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

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

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

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