RISK FACTORS

Set out below are certain risk factors which could affect the Lloyds TSB Group's future results and cause them to be materially different from expected results. The factors discussed in this report should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

Lloyds TSB Group's businesses are subject to inherent risks concerning borrower credit quality as well as general UK and international economic conditions. Development of adverse conditions in the UK or in other major economies could cause profitability to decline.

Lloyds TSB Group's businesses are subject to inherent risks regarding borrower credit quality as well as general UK economic conditions. Each of these can change the level of demand for, and supply of, Lloyds TSB Group's products and services. Changes in the credit quality of Lloyds TSB Group's UK and/or international borrowers and counterparties could reduce the value of Lloyds TSB Group's assets, and increase provisions for bad and doubtful debts. In addition, changes in economic conditions may result in a deterioration in the value of security held against lending exposures and increase the risk of loss in the event of borrower default. Any significant increase in the UK unemployment rate would reduce profits from the insurance business. Furthermore, a general deterioration in the UK economy would also reduce Lloyds TSB Group's profit from both its UK banking and financial services businesses. A general deterioration in any other major world economy could also adversely impact Lloyds TSB Group's profitability. See 'Operating and financial review and prospects – Risk management – Credit risk'.

Lloyds TSB Group's businesses are inherently subject to the risk of market fluctuations, which could reduce profitability.

Lloyds TSB Group's businesses are inherently subject to the risk of market fluctuations. The most significant market risks Lloyds TSB Group faces are those that impact the Group's pension schemes principally equity risk and interest rate risk; adverse market movements would have an effect upon the financial condition of the pension schemes which would be reflected in the Lloyds TSB Group's financial statements. Interest rate risk and foreign exchange risk arises from banking activities while equity risk is present in the insurance businesses. See 'Operating and financial review and prospects – Risk management – Market risk' for a discussion of these risks.

Lloyds TSB Group's insurance businesses are subject to inherent risks relating to changing demographic developments, adverse weather and similar contingencies outside its control. Development of adverse conditions could reduce profitability.

Lloyds TSB Group's insurance businesses are subject to inherent risk relating to changing demographic developments, adverse weather and similar contingencies outside its control, both in the UK and overseas. Such contingencies can change the risk profile and profitability of such products and services.

Adverse experience in the operational risks inherent in Lloyds TSB Group's businesses could have a negative impact on its results of operations.

Operational risks are present in Lloyds TSB Group's businesses, including the risk of loss resulting from inadequate or failed internal and external processes, documentation, people and systems or from external events. Lloyds TSB Group's businesses are dependent on their ability to process accurately and efficiently a high volume of complex transactions across numerous and diverse products and services, in different currencies and subject to a number of different legal and regulatory regimes. Lloyds TSB Group's systems and processes are designed to ensure that the operational risks associated with its activities are appropriately controlled, but Lloyds TSB Group realises that any weakness in these systems could have a negative impact on its results of operations during the affected period. See 'Operating and financial review and prospects – Risk management – Operations risk' and 'Operating and financial review and prospects – Risk management – Legal and regulatory risk'.

Terrorist acts and other acts of war could have a negative impact on the business and results of operations of Lloyds TSB Group.

Terrorist acts, and other acts of war or hostility and responses to those acts, may create economic and political uncertainties, which could have a negative impact on UK and international economic conditions generally, and more specifically on the business and results of operations of Lloyds TSB Group in ways that cannot be predicted.

Lloyds TSB Group's businesses are subject to substantial regulation, regulatory and governmental oversight. Any significant adverse regulatory developments or changes in government policy could have a negative impact on Lloyds TSB Group's results of operations.

Lloyds TSB Group conducts its businesses subject to ongoing regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies, voluntary codes of practice and interpretations in the UK and the other markets where it operates. Future changes in regulation, fiscal or other policies are unpredictable and beyond the control of Lloyds TSB Group. For additional information, see 'Regulation'.

Lloyds TSB Group is exposed to various forms of legal risk including the risk of misselling financial products, acting in breach of legal or regulatory principles or requirements and giving negligent advice, any of which could have a negative impact on its results or its relations with its customers.

Some of these issues involve the possibility of alleged misselling of pension and other life assurance policies, savings and other products. There is a risk that further provisions may be required as a result of these issues. See 'Operating and financial review and prospects – Risk management – Customer treatment risk – Customer remediation payments'.

Certain aspects of the Lloyds TSB Group's business may be determined by the authorities or the courts as not being conducted in accordance with relevant laws. Obligations under contracts may not be enforced as anticipated or may be enforced in a manner detrimental to the Lloyds TSB Group or the Lloyds TSB Group could be liable in damages to others for the way in which it conducts its business.

Lloyds TSB Group's businesses are conducted in highly competitive environments. Creation of an appropriate return for shareholders depends upon management's ability to respond effectively to competitive pressures.

The market for UK financial services and the other markets within which Lloyds TSB Group operates are highly competitive, and management expects such competition to intensify in response to consumer demand, technological changes, the impact of consolidation, regulatory actions and other factors, which could result in a reduction in profit margins. Lloyds TSB Group's ability to generate an appropriate return for its shareholders depends significantly upon the competitive environment and management's response to it. See 'Business – Competitive environment'.

Lloyds TSB Group is devoting considerable time and resources to securing new customers and developing more business from existing customers. If Lloyds TSB Group is unsuccessful, its organic growth prospects will decline.

Lloyds TSB Group seeks to achieve further organic growth by securing new customers and developing more business from existing customers. Lloyds TSB Group is currently expending significant resources and effort to bring about this growth, particularly with respect to its UK retail financial services business. If these expenditures and efforts do not meet with success, its operating results would grow more slowly or decline.

Lloyds TSB Group's businesses are conducted in a marketplace that is consolidating and significant cross-border mergers and acquisitions may happen in the coming years. Lloyds TSB Group's ability to generate an appropriate return for its shareholders over the long term may depend upon whether management is able or permitted by either regulatory bodies or its shareholders to achieve value-creating mergers and/or acquisitions at the appropriate times and prices.

In addition to its important strategy of organic growth, one of Lloyds TSB Group's aims is to remain alert for opportunities to participate in the further consolidation of the financial services industry, both in the UK and overseas. Management believes that under current conditions Lloyds TSB Group may find it difficult to make a significant acquisition in the UK in any business line where it already has a significant market share. Lloyds TSB Group's ability to generate an appropriate return for its shareholders over the long term may depend upon whether management is able to achieve value-creating mergers and/or acquisitions at the appropriate times and prices. Lloyds TSB Group cannot be sure that it will ultimately be able to make any such mergers or acquisitions.

FORWARD LOOKING STATEMENTS

This annual report includes certain forward-looking statements with respect to the business, strategy and plans of Lloyds TSB Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Lloyds TSB Group's or management's beliefs and expectations, are forward-looking statements. Words such as "believes", "anticipates", "estimates", "expects", "intends", "aims", "potential", "will", "could", "considered", "likely", "estimate" and variations of these words and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future.

Examples of such forward-looking statements include, but are not limited to:

- projections or expectations of profit attributable to shareholders, provisions, economic profit, dividends, capital structure or any other financial items or ratios;
- statements of plans, objectives or goals of Lloyds TSB Group or its management;
- statements about the future trends in interest rates, stock market levels and demographic trends and any impact on Lloyds TSB Group;
- statements concerning any future UK or other economic environment or performance, including in particular any such statements included in this annual report in "Operating and Financial Review and Prospects";
- statements about strategic goals, competition, regulation, dispositions and consolidation or technological developments in the financial services industry; and
- statements of assumptions underlying such statements.

Factors that could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements made by Lloyds TSB Group or on Lloyds TSB Group's behalf include, but are not limited to:

- general economic conditions in the UK and internationally;
- inflation, interest rate, exchange rate, market and monetary fluctuations;
- changing demographic developments, adverse weather and similar contingencies outside the Lloyds TSB Group's control;
- inadequate or failed internal or external processes, people and systems;
- terrorist acts and other acts of war or hostility and responses to those acts;
- changes in laws, regulations or taxation;
- changes in competition and pricing environments;
- the ability to secure new customers and develop more business from existing customers;
- the ability to achieve value-creating mergers and/or acquisitions at the appropriate time and prices; and
- the success of the Lloyds TSB Group in managing the risks of the foregoing.

Lloyds TSB Group plc may also make or disclose written and/or oral forward-looking statements in reports filed with or furnished to the US Securities and Exchange Commission, Lloyds TSB Group plc's annual report and accounts to shareholders, proxy statements, offering circulars, prospectuses, press releases and other written materials and in oral statements made by the directors, officers or employees of Lloyds TSB Group plc to third parties, including financial analysts. The forward-looking statements contained in this annual report are made as of the date hereof, and Lloyds TSB Group undertakes no obligation to update any of its forward-looking statements.

LLOYDS TSB GROUP STRUCTURE

The following is a list of the principal subsidiaries of Lloyds TSB Group plc at 31 December 2004. The audited consolidated accounts of Lloyds TSB Group plc for the year ended 31 December 2004 include the audited accounts of each of these companies.

Name of subsidiary undertakings	Country of registration/ Incorporation	Percentage of equity share capital and voting rights held	Nature of business	Registered office
Lloyds TSB Bank plc	England	100%	Banking and financial services	25 Gresham Street London EC2V 7HN
Cheltenham & Gloucester plc	England	100%*	Mortgage lending and retail investments	Barnett Way Gloucester GL4 3RL
Lloyds TSB Commercial Finance Limited	England	100%*	Credit factoring	Beaumont House Beaumont Road, Banbury Oxfordshire OX16 7RN
Lloyds TSB Leasing Limited	England	100%*	Financial leasing	25 Gresham Street London EC2V 7HN
Lloyds TSB Private Banking Limited	England	100%*	Private banking	25 Gresham Street London EC2V 7HN
The Agricultural Mortgage Corporation PLC	England	100%*	Long-term agricultural finance	Charlton Place Charlton Road Andover Hampshire SP10 1RE
Lloyds TSB Bank Offshore Limited	Jersey	100%*	Banking and financial services	25 New Street St Helier Jersey JE4 8RG
Lloyds TSB Scotland plc	Scotland	100%*	Banking and financial services	Henry Duncan House 120 George Street Edinburgh EH2 4LH
Lloyds TSB General Insurance Limited	England	100%*	General insurance	25 Gresham Street London EC2V 7HN
Scottish Widows Investment Partnership Group Limited	England	100%*	Investment management	10 Fleet Place London EC4M 7RH
Lloyds TSB Insurance Services Limited	England	100%*	Insurance broking	25 Gresham Street London EC2V 7HN
Lloyds TSB Asset Finance Division Limited	England	100%*	Consumer credit, leasing and related services	25 Gresham Street London EC2V 7HN
Black Horse Limited	England	100%*	Consumer credit, leasing and related services	25 Gresham Street London EC2V 7HN
Scottish Widows plc	Scotland	100%*	Life assurance	69 Morrison Street Edinburgh EH3 8YF
Scottish Widows Annuities Limited	Scotland	100%*	Life assurance	69 Morrison Street Edinburgh EH3 8YF

* Indirect interest

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Report of the independent Registered Public Accounting Firm

To the Shareholders of Lloyds TSB Group plc:

We have audited the accompanying consolidated balance sheets of Lloyds TSB Group plc and its subsidiaries as of 31 December 2004 and 31 December 2003, and the related consolidated profit and loss account, consolidated statement of total recognised gains and losses, reconciliation of movements in shareholders’ funds and consolidated cash flow statement for each of the three years in the period ended 31 December 2004 which, as described in Note 1, have been prepared on the basis of accounting principles generally accepted in the United Kingdom. These financial statements are the responsibility of the management of Lloyds TSB Group plc. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lloyds TSB Group plc and its subsidiary undertakings at 31 December 2004 and 31 December 2003, and the results of their operations and their cash flows, for each of the three years in the period ended 31 December 2004 in conformity with accounting principles generally accepted in the United Kingdom.

Accounting principles generally accepted in the United Kingdom vary in certain significant respects from accounting principles generally accepted in the United States. The application of the latter would have affected the determination of consolidated net income for each of the three years in the period ended 31 December 2004 and the determination of consolidated shareholders’ equity at 31 December 2004 and 2003 to the extent summarised in Note 50 to the consolidated financial statements.

PricewaterhouseCoopers LLP
Southampton, England
3 March 2005, except for Note 50, as to which the date is 29 June 2005.

Consolidated profit and loss account

for the year ended 31 December 2004

	Note	**2004 £ million**	Continuing operations 2003 £ million	Discontinued operations 2003* £ million	Total 2003 £ million	2002† £ million
Interest receivable:						
Interest receivable and similar income arising from debt securities		**423**	389	63	452	567
Other interest receivable and similar income		**9,972**	8,484	1,213	9,697	9,982
Interest payable		**5,475**	4,129	765	4,894	5,378
Net interest income		**4,920**	4,744	511	5,255	5,171
Other finance income	45	**39**	34	–	34	165
Other income						
Fees and commissions receivable		**3,124**	2,987	112	3,099	3,053
Fees and commissions payable		**(744)**	(688)	(34)	(722)	(645)
Dealing profits (before expenses)	3	**271**	525	35	560	188
Income from long-term assurance business	29	**715**	436	17	453	(294)
General insurance premium income		**554**	535	–	535	486
Other operating income		**688**	682	12	694	763
		4,608	4,477	142	4,619	3,551
Total income		**9,567**	9,255	653	9,908	8,887
Operating expenses						
Administrative expenses	4	**4,284**	4,229	247	4,476	4,212
Depreciation and amortisation	23,24	**633**	672	25	697	701
Total operating expenses		**4,917**	4,901	272	5,173	4,913
Trading surplus		**4,650**	4,354	381	4,735	3,974
General insurance claims		**224**	236	–	236	229
Provisions for bad and doubtful debts	15					
Specific		**953**	883	63	946	965
General		**(87)**	4	–	4	64
		866	887	63	950	1,029
Amounts written off fixed asset investments	5	**52**	44	–	44	87
Operating profit		**3,508**	3,187	318	3,505	2,629
Share of results of joint ventures	20	**–**	(22)	–	(22)	(11)
(Loss) profit on sale of businesses	6	**(15)**	–	865	865	–
Profit on ordinary activities before tax	8	**3,493**	3,165	1,183	4,348	2,618
Tax on profit on ordinary activities	9	**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	39	**42**			47	43
Profit for the year attributable to shareholders		**2,421**			3,254	1,790
Dividends	10	**1,914**			1,911	1,908
Profit (loss) for the year	41	**507**			1,343	(118)
Earnings per share	11	**43.3p**			58.3p	32.1p
Diluted earnings per share	11	**43.0p**			58.1p	32.0p

* See note 6

† An analysis of the results for the year ended 31 December 2002 between continuing and discontinued operations is given in note 7.

The accompanying notes are an integral part of the financial statements.

Consolidated balance sheet

at 31 December 2004

	Note	**2004 £ million**	2003 £ million
Assets			
Cash and balances at central banks		**1,078**	1,195
Items in course of collection from banks		**1,462**	1,447
Treasury bills and other eligible bills	12	**92**	539
Loans and advances to banks	13	**23,565**	15,547
Loans and advances to customers	14	**154,240**	135,251
Debt securities	17	**25,194**	28,669
Equity shares	18	**215**	458
Interests in joint ventures:	20		
Share of gross assets		**84**	85
Share of gross liabilities		**(31)**	(31)
		53	54
Intangible fixed assets	23	**2,425**	2,513
Tangible fixed assets	24	**4,181**	3,918
Other assets	27	**3,220**	3,944
Prepayments and accrued income	28	**2,573**	1,918
Long-term assurance business attributable to the shareholder	29	**6,781**	6,481
		225,079	201,934
Long-term assurance assets attributable to policyholders	29	**54,764**	50,078
Total assets		**279,843**	252,012

The accompanying notes are an integral part of the financial statements.

Consolidated balance sheet

at 31 December 2004

	Note	2004 £ million	2003 £ million
Liabilities			
Deposits by banks	31	**39,738**	23,955
Customer accounts	32	**122,062**	116,496
Items in course of transmission to banks		**631**	626
Debt securities in issue	33	**27,217**	25,922
Other liabilities	34	**6,619**	7,007
Accruals and deferred income	35	**3,866**	3,206
Post-retirement benefit liability	45	**2,231**	2,139
Provisions for liabilities and charges:			
Deferred tax	36	**1,473**	1,376
Other provisions for liabilities and charges	37	**417**	402
Subordinated liabilities:			
Undated loan capital	38	**5,852**	5,959
Dated loan capital	38	**4,400**	4,495
		10,252	10,454
Minority interests:			
Equity		**46**	44
Non-equity	39	**550**	683
		596	727
Called-up share capital	40	**1,419**	1,418
Share premium account	41	**1,145**	1,136
Merger reserve	41	**343**	343
Profit and loss account	41	**7,070**	6,727
Shareholders' funds (equity and non-equity)	42	**9,977**	9,624
		225,079	201,934
Long-term assurance liabilities to policyholders	29	**54,764**	50,078
Total liabilities		**279,843**	252,012
Memorandum items	46		
Contingent liabilities:			
Acceptances and endorsements		**71**	299
Guarantees and assets pledged as collateral security		**6,786**	6,122
Other contingent liabilities		**1,669**	2,604
		8,526	9,025
Commitments		**85,290**	79,335

The accompanying notes are an integral part of the financial statements.

Other statements

Statement of total recognised gains and losses
for the year ended 31 December 2004

	Note	**2004 £ million**	2003 £ million	2002 £ million
Profit attributable to shareholders		**2,421**	3,254	1,790
Currency translation differences on foreign currency net investments		**(11)**	118	(3)
Actuarial losses recognised in post-retirement benefit schemes		**(237)**	(6)	(3,299)
Deferred tax thereon		**71**	2	968
	45	**(166)**	(4)	(2,331)
Total recognised gains and losses relating to the year		**2,244**	3,368	(544)
Prior year adjustments in respect of changes in accounting policy in earlier years		**–**	(29)	(404)
Total gains and losses recognised during the year		**2,244**	3,339	(948)

Historical cost profits and losses
for the year ended 31 December 2004

There was no material difference between the results as reported and the results that would have been reported on an unmodified historical cost basis. Accordingly, no note of historical cost profits and losses has been included.

Reconciliation of movements in consolidated shareholders' funds
for the year ended 31 December 2004

	Note	**2004 £ million**	2003 £ million	2002 £ million
Profit attributable to shareholders		**2,421**	3,254	1,790
Dividends		**(1,914)**	(1,911)	(1,908)
Profit for the year		**507**	1,343	(118)
Currency translation differences on foreign currency net investments		**(11)**	118	(3)
Actuarial losses recognised in post-retirement benefit schemes	45	**(166)**	(4)	(2,331)
Issue of shares	40,41	**10**	45	139
Movements in relation to own shares	43	**10**	(2)	(70)
Goodwill written back on sale of businesses	6	**3**	181	–
Net increase in shareholders' funds		**353**	1,681	(2,383)
Shareholders' funds at beginning of year		**9,624**	7,943	10,326
Shareholders' funds at end of year		**9,977**	9,624	7,943

The accompanying notes are an integral part of the financial statements.

Consolidated cash flow statement
for the year ended 31 December 2004

	Note	**2004 £ million**	2003 £ million	2002 £ million
Net cash inflow from operating activities	49a	**3,469**	772	5,394
Dividends received from joint ventures and associated undertakings		**2**	5	2
Returns on investments and servicing of finance:				
– Dividends paid to equity minority interests	49d	**(24)**	(14)	(18)
– Payments made to non-equity minority interests	49d	**(44)**	(81)	(43)
– Interest paid on subordinated liabilities (loan capital)		**(606)**	(600)	(463)
Net cash outflow from returns on investments and servicing of finance		**(674)**	(695)	(524)
Taxation:				
– UK corporation tax		**(656)**	(598)	(758)
– Overseas tax		**(107)**	(186)	(193)
Total taxation		**(763)**	(784)	(951)
Capital expenditure and financial investment:				
– Additions to fixed asset investments		**(10,088)**	(35,420)	(46,830)
– Disposals and maturities of fixed asset investments		**9,732**	36,281	45,507
– Additions to tangible fixed assets		**(1,183)**	(778)	(1,315)
– Disposals of tangible fixed assets		**243**	287	359
– Capital injections to long-term assurance business		**–**	–	(140)
Net cash (outflow) inflow from capital expenditure and financial investment		**(1,296)**	370	(2,419)
Acquisitions and disposals:				
– Additions to interests in joint ventures		**–**	(12)	(21)
– Acquisition of group undertakings and businesses	49e	**(16)**	(1,106)	(117)
– Disposal of group undertakings and businesses	49g	**(25)**	2,382	–
Net cash (outflow) inflow from acquisitions and disposals		**(41)**	1,264	(138)
Equity dividends paid		**(1,913)**	(1,908)	(1,903)
Net cash outflow before financing		**(1,216)**	(976)	(539)
Financing:				
– Issue of subordinated liabilities (loan capital)	49d	**699**	533	2,120
– Cash proceeds from issue of ordinary share capital and transactions in own shares held in respect of employee share schemes		**11**	32	77
– Repayments of subordinated liabilities (loan capital)	49d	**(764)**	(75)	(55)
– Minority investment in subsidiaries	49d	**–**	–	167
– Repayment of minority investment in subsidiaries	49d	**(132)**	–	–
– Capital element of finance lease rental payments	49d	**(1)**	(1)	(4)
Net cash (outflow) inflow from financing		**(187)**	489	2,305
(Decrease) increase in cash	49c	**(1,403)**	(487)	1,766

The accompanying notes are an integral part of the financial statements.

Notes to the accounts

1 Accounting policies

Accounting policies are unchanged from 2003.

In December 2004, the Accounting Standards Board (‘ASB’) issued Financial Reporting Standard 27 ‘Life Assurance’. The Group will implement the requirements of this standard in its 2005 accounts; however, in accordance with the Memorandum of Understanding entered into by leading members of the life assurance and bancassurance sectors and the Association of British Insurers with the ASB, certain additional disclosures have been given in ‘Operating and financial review and prospects’ attached to these accounts.

a Accounting convention

The consolidated accounts are prepared under the historical cost convention as modified by the revaluation of debt securities and equity shares held for dealing purposes (see g) and assets held in the long-term assurance business (see o); in compliance with Section 255A, Schedule 9 and other requirements of the Companies Act 1985 except as described below (see c); in accordance with applicable accounting standards, pronouncements of the Urgent Issues Task Force and with the Statements of Recommended Practice issued by the British Bankers’ Association and the Finance & Leasing Association. The Group’s methodology for calculating embedded value follows the guidance published by the Association of British Insurers for the preparation of figures using the achieved profits method of accounting except that tangible assets attributable to the shareholder are valued at market value. The guidance would require those assets backing capital requirements to be discounted to reflect the cost of encumbered capital, but such a treatment would be inconsistent with the treatment of capital supporting the Group’s banking operations.

The Group continues to take advantage of the dispensation in the Urgent Issues Task Force’s Abstract 17 ‘Employee Share Schemes’ not to apply that Abstract to the Group’s Inland Revenue approved SAYE schemes.

b Basis of consolidation

Assets, liabilities and results of group undertakings and joint ventures are included in the consolidated accounts on the basis of accounts made up to 31 December. Entities that do not meet the legal definition of a subsidiary but which give rise to benefits that are in substance no different to those that would arise from subsidiaries are also included in the consolidated accounts. In order to reflect the different nature of the shareholder’s and policyholders’ interests in the long-term assurance business, the value of long-term assurance business attributable to the shareholder and the assets and liabilities attributable to policyholders are classified under separate headings in the consolidated balance sheet. Details of transactions entered into by the Group which are not eliminated on consolidation are given in note 44.

c Goodwill

Goodwill arising on acquisitions of or by group undertakings is capitalised. For acquisitions prior to 1 January 1998, goodwill was taken direct to reserves in the year of acquisition. As permitted by the transitional arrangements of Financial Reporting Standard 10, ‘Goodwill and Intangible Assets’, this goodwill was not reinstated when the Group adopted the standard in 1998.

The useful economic life of the goodwill arising on each acquisition is determined at the time of the acquisition. The directors consider that it is appropriate to assign an indefinite life to the goodwill which arose on the acquisition of Scottish Widows during 2000 in view of the strength of the Scottish Widows brand, developed through over 185 years of trading, and the position of the business as one of the leading providers of life, pensions, unit trust and fund management products. Both of these attributes are deemed to have indefinite durability, which has been determined based on the following factors: the nature of the business; the typical life spans of the products; the extent to which the acquisition overcomes market entry barriers; and the expected future impact of competition on the business.

As a result, the Scottish Widows goodwill is not being amortised through the profit and loss account; however, it is subjected to annual impairment reviews in accordance with Financial Reporting Standard 11, ‘Impairment of Fixed Assets and Goodwill’. Impairment of the goodwill is evaluated by comparing the present value of the expected future cash flows, excluding financing and tax, (the ‘value-in-use’) to the carrying value of the underlying net assets and goodwill. If the net assets and goodwill were to exceed the value-in-use, an impairment would be deemed to have occurred and the resulting write-down in the goodwill would be charged to the profit and loss account immediately.

Paragraph 28 of Schedule 9 to the Companies Act 1985 requires that all goodwill carried on the balance sheet should be amortised. In the case of the goodwill arising on the acquisition of Scottish Widows, the directors consider that it is appropriate to depart from this requirement in order to comply with the over-riding requirement for the accounts to show a true and fair view. If this goodwill was amortised over a period of 20 years, profit before tax for the year ended 31 December 2004 would be £92 million lower (2003: £93 million lower; 2002: £93 million lower), with a corresponding reduction in reserves of £450 million (2003: £358 million); intangible assets on the balance sheet would also be £450 million lower (2003: £358 million lower).

Goodwill arising on all other acquisitions after 1 January 1998 is amortised on a straight line basis over its estimated useful economic life, which does not exceed 20 years.

1 Accounting policies (continued)

At the date of the disposal of group or associated undertakings, any unamortised goodwill, or goodwill taken directly to reserves prior to 1 January 1998, is included in the Group's share of the net assets of the undertaking in the calculation of the profit or loss on disposal.

d Income recognition

Interest income is recognised in the profit and loss account as it accrues, with the exception of interest on non-performing lending which is taken to income either when it is received or when there ceases to be any significant doubt about its ultimate receipt (see e).

Fees and commissions receivable from customers to reimburse the Group for costs incurred are taken to income when due. Fees and commissions relating to the ongoing provision of a service or risk borne for a customer are taken to income in proportion to the service provided or risk borne in each accounting period. Fees and commissions charged in lieu of interest are taken to income on a level yield basis over the period of the loan. Other fees and commissions receivable are accounted for as they fall due.

e Provisions for bad and doubtful debts and non-performing lending

Provisions for bad and doubtful debts

It is the Group's policy to make provisions for bad and doubtful debts, by way of a charge to the profit and loss account, to reflect the losses inherent in the loan portfolio at the balance sheet date. There are two types of provision, specific and general, and these are discussed further below.

Specific provisions

Specific provisions relate to identified risk advances and are raised when the Group considers that recovery of the whole of the outstanding balance is in serious doubt. The amount of the provision is equivalent to the amount necessary to reduce the carrying value of the advance to its expected ultimate net realisable value.

For the Group's portfolios of smaller balance homogeneous loans, such as the residential mortgage, personal lending and credit card portfolios, specific provisions are calculated using a formulae driven approach. These formulae take into account factors such as the length of time that payments from the customer are overdue, the value of any collateral held and the level of past and expected losses, in order to derive an appropriate provision.

For the Group's other lending portfolios, specific provisions are calculated on a case-by-case basis. In establishing an appropriate provision, factors such as the financial condition of the customer, the nature and value of any collateral held and the costs associated with obtaining repayment and realisation of the collateral are taken into consideration.

General provisions

General provisions are raised to cover latent bad and doubtful debts which are present in any portfolio of advances but have not been specifically identified. The Group has general provisions, held against each of its principal lending portfolios, which are calculated after having regard to a number of factors; in particular, the level of watchlist or potential problem debt, the observed propensity for such debt to deteriorate and become impaired and prior period loss rates. The level of general provision held is reviewed on a regular basis to ensure that it remains appropriate in the context of the perceived risk inherent in the related portfolio and the prevailing economic climate.

Non-performing lending

An advance becomes classified as non-performing when interest ceases to be credited to the profit and loss account. There are two types of non-performing lending which are discussed further below.

Accruing loans on which interest is being placed in suspense

Where the customer continues to operate the account, but there is doubt about the payment of interest, interest continues to be charged to the customer's account, but it is not applied to income. Interest is placed on a suspense account and only taken to income if there ceases to be doubt about its being paid.

Loans accounted for on a non-accrual basis

In those cases where the operation of the customer's account has ceased and it has been transferred to a specialist recovery department, the advance is written down to its expected net realisable value and interest is no longer charged to the customer's account as the likelihood of its recovery is considered remote. Interest is only taken to income if it is received.

f Mortgage incentives

Payments made under cash gift and discount mortgage schemes, which are recoverable from the customer in the event of early redemption, are amortised as an adjustment to net interest income over the early redemption charge period. Payments cease to be deferred and are charged to the profit and loss account in the event that the related loan is redeemed or becomes impaired.

1 Accounting policies (continued)

g Debt securities and equity shares

Debt securities, apart from those held for dealing purposes and in the long-term assurance business (see n), are stated at cost as adjusted for the amortisation of any premiums and discounts arising on acquisition, which are amortised from purchase to maturity in equal annual instalments, less amounts written off for any permanent diminution in their value. Equity shares, apart from those held for dealing purposes and in the long-term assurance business (see n), are stated at cost less amounts written off for any permanent diminution in their value.

Debt securities and equity shares held for dealing purposes are included at market value. In circumstances where securities are transferred between the dealing and investment portfolios, the transfer is effected at an amount based on the market value at the date of transfer. Any resulting profit or loss is reflected in the profit and loss account.

h Tangible fixed assets

Tangible fixed assets are included at cost less depreciation.

Land is not depreciated. Leasehold premises with unexpired lease terms of 50 years or less are depreciated by equal annual instalments over the remaining period of the lease. Freehold and long leasehold buildings are depreciated over 50 years. The costs of adapting premises for the use of the Group are separately identified and depreciated over 10 years, or over the term of the lease if less; such costs are included within premises in the balance sheet total of tangible fixed assets.

Equipment is depreciated by equal annual instalments over the estimated useful lives of the assets, which for fixtures and furnishings are 10-20 years and for computer hardware, operating software and application software and the related development costs relating to separable new systems, motor vehicles and other equipment are 3-8 years.

Premises and equipment held for letting to customers under operating leases are depreciated over the life of the lease to give a constant rate of return on the net cash investment, taking into account tax and anticipated residual values. Anticipated residual values are reviewed regularly and any impairments identified are charged to the profit and loss account.

i Vacant leasehold property

When a leasehold property ceases to be used in the business or a commitment is entered into which would cause this to occur, provision is made to the extent that the recoverable amount of the interest in the property is expected to be insufficient to cover future obligations relating to the lease.

j Leasing and instalment credit transactions

Assets leased to customers are classified as finance leases if the lease agreements transfer substantially all of the risks and rewards of ownership to the lessee; all other leases are classified as operating leases.

Income from finance leases is credited to the profit and loss account in proportion to the net cash invested so as to give a constant rate of return over each period after taking account of tax. Income from instalment credit transactions is credited to the profit and loss account using the sum of the digits method. Rental income from operating leases is credited to the profit and loss account on an accruals basis.

In those cases where the Group is the lessee, operating lease costs are charged to the profit and loss account in equal annual instalments over the life of the lease.

k Deferred tax

Full provision is made for deferred tax liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in a tax computation. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted, or where they can be offset against deferred tax liabilities. Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

l Pensions and other post-retirement benefits

The Group operates both defined benefit and defined contribution post-retirement benefit schemes.

Full actuarial valuations of the Group’s principal defined benefit schemes are carried out every three years with interim reviews in the intervening years; these valuations are updated to 31 December each year by qualified independent actuaries, or in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows. For the purposes of these annual updates, scheme assets are included at market value and scheme liabilities are measured on an actuarial basis using the projected unit method; these liabilities are discounted at the current rate of return on an AA corporate bond of equivalent currency and term. The post-retirement benefit surplus or deficit is included on the Group’s balance sheet, net of the related amount of deferred tax. Surpluses are included only to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes.

1 Accounting policies (continued)

The current service cost and any past service costs are included in the profit and loss account within operating expenses and the expected return on the schemes' assets, after deducting the impact of the unwinding of the discount on scheme liabilities, is included within other finance income. Actuarial gains and losses, including differences between the expected and actual return on scheme assets, are recognised, net of the related deferred tax, in the statement of total recognised gains and losses.

The costs of the Group's defined contribution pension schemes are charged to the profit and loss account in the period in which they fall due.

m Foreign currency translation

Assets, liabilities and results in foreign currencies are expressed in sterling at the rates of exchange ruling on the dates of the respective balance sheets. Exchange adjustments on the translation of opening net assets held overseas are taken direct to reserves. All foreign exchange gains and losses, which arise from normal trading activities, are included in the profit and loss account.

n Long-term assurance business

The Group accounts for its interest in long-term assurance business using the embedded value basis of accounting. The value of the shareholder's interest in the long-term assurance business ('the embedded value') included in the Group's balance sheet is an actuarially determined estimate of the economic value of the Group's life assurance subsidiaries, excluding any value which may be attributed to future new business. The embedded value is comprised of the net tangible assets of the life assurance subsidiaries, including any surplus retained within the long-term business funds, which could be transferred to the shareholder, and the present value of the in-force business. The present value of the in-force business is calculated by projecting the future surpluses and other net cash flows attributable to the shareholder arising from business written by the balance sheet date, using appropriate economic and actuarial assumptions, and discounting the result at a rate which reflects the shareholder's overall risk premium attributable to this business.

Surpluses arise following annual actuarial valuations of the long-term business funds, which are carried out in accordance with the statutory requirements designed to ensure and demonstrate the solvency of the funds. Future surpluses will depend upon experience in a number of areas such as investment returns, lapse rates, mortality and administrative expenses. Surpluses can be projected by making realistic assumptions about future experience, having regard to both actual experience and forecast long-term economic trends. Other net cash flows principally comprise annual management charges and other fees levied upon the policyholders by the life assurance subsidiaries.

Changes in the embedded value, which are determined on a post-tax basis, are included in the profit and loss account. For the purpose of presentation, the change in this value is grossed up at the underlying rate of corporation tax.

The assets held within the long-term business funds of the Group's life assurance operations are legally owned by the Group, however the shareholder will only benefit from ownership of these assets to the extent that surpluses are declared or from other cash flows attributable to the shareholder. Reflecting the different nature of these assets, they are classified separately on the Group's balance sheet as 'Long-term assurance assets attributable to policyholders', with a corresponding liability to the policyholders also shown. Investments held within the long-term business funds are included on the following basis: equity shares, debt securities and unit trusts held for unit-linked funds are valued in accordance with policy conditions at market prices; other equity shares and debt securities are valued at middle market price and other unit trusts at bid price; investment properties are included at valuation by independent valuers at existing use value at the balance sheet date, and mortgages and loans are at cost less amounts written off.

o General insurance business

The Group both underwrites and acts as intermediary in the sale of general insurance products. Underwriting premiums are included, net of refunds, in the period in which insurance cover is provided to the customer; premiums received relating to future periods are deferred and only credited to the profit and loss account when earned. Where the Group acts as intermediary, commission income is included in the profit and loss account at the time that the underwriter accepts the risk of providing insurance cover to the customer. Where appropriate, provision is made for the effect of future policy terminations based upon past experience.

The underwriting business makes provision for the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date. Claims equalisation provisions are calculated in accordance with the relevant legislative requirements.

1 Accounting policies (continued)

p Sale and repurchase transactions

Securities which have been sold with an agreement to repurchase continue to be shown on the balance sheet and the sale proceeds recorded within deposits by banks or customer accounts as appropriate. Securities acquired in reverse sale and repurchase transactions are not recognised on the balance sheet and the purchase price is recorded within loans and advances. The difference between the sale price and repurchase price is accrued evenly over the life of the transaction and charged or credited to the profit and loss account as interest payable or receivable.

q Derivatives

Derivatives are used in the Group’s trading activities to meet the financial needs of customers, for proprietary purposes and to manage risk in the Group’s trading portfolios. Such instruments include exchange rate forwards and futures, currency swaps and options together with interest rate swaps, forward rate agreements, interest rate options and futures. These derivatives are carried at fair value and all changes in fair value are reported within dealing profits in the profit and loss account. Fair values are normally determined by reference to quoted market prices; internal models are used to determine fair value in instances where no market price is available. The unrealised gains and losses on trading derivatives are included within other assets and other liabilities respectively. These items are reported gross except in instances where the Group has entered into legally binding netting agreements, where the Group has a right to insist on net settlement that would survive the insolvency of the counterparty; in these cases the positive and negative fair values of trading derivatives with the relevant counterparties are offset within the balance sheet totals.

Derivatives used in the Group’s non-trading activities are taken out to reduce exposures to fluctuations in interest and exchange rates and include exchange rate forwards and futures, currency swaps together with interest rate swaps, forward rate agreements and options. These derivatives are accounted for in the same way as the underlying items which they are hedging. Interest receipts and payments on hedging interest derivatives are included in the profit and loss account so as to match the interest payable or receivable on the hedged item.

A derivative will only be classified as a hedge in circumstances where there was reasonable evidence of the intention to hedge at the outset of the transaction and the derivative substantially matches or eliminates a proportion of the risk associated with the exposure being hedged.

Where a hedge transaction is superseded, ceases to be effective or is terminated early the derivative is measured at fair value. Any profit or loss arising is then amortised to the profit and loss account over the remaining life of the item which it was originally hedging. When the underlying asset, liability or position that was being hedged is terminated, the hedging derivative is measured at fair value and any profit or loss arising is recognised immediately.

2 Segmental analysis

The Group's activities are organised into three businesses: 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, private banking and mortgages to personal customers. Insurance and Investments offers life assurance, pensions and savings 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. It also provides asset finance to personal and corporate customers, manages the Group's activities in financial markets through its Treasury function and provides banking and financial services overseas.

Year ended 31 December 2004	UKRetail Banking £m	General insurance £m	Life pensions, unit trusts and asset management £m	Insurance and Investments £m	Wholesale and International Banking £m	Central group items £m	Continuing operations £m	Discontinued operations§ £m	Total £m
Net interest income	**3,198**	**44**	**55**	**99**	**1,966**	**(343)**	**4,920**	**–**	**4,920**
Other finance income	**–**	**–**	**–**	**–**	**–**	**39**	**39**	**–**	**39**
Other operating income	**1,639**	**497**	**818**	**1,315**	**1,641**	**13**	**4,608**	**–**	**4,608**
Total income	**4,837**	**541**	**873**	**1,414**	**3,607**	**(291)**	**9,567**	**–**	**9,567**
Operating expenses	**(2,513)**	**(149)**	**(123)**	**(272)**	**(2,090)**	**(42)**	**(4,917)**	**–**	**(4,917)**
Trading surplus (deficit)	**2,324**	**392**	**750**	**1,142**	**1,517**	**(333)**	**4,650**	**–**	**4,650**
General insurance claims	**–**	**(224)**	**–**	**(224)**	**–**	**–**	**(224)**	**–**	**(224)**
Provisions for bad and doubtful debts	**(673)**	**–**	**–**	**–**	**(193)**	**–**	**(866)**	**–**	**(866)**
Amounts written off fixed asset investments	**–**	**–**	**–**	**–**	**(52)**	**–**	**(52)**	**–**	**(52)**
Loss on sale of businesses	**–**	**–**	**–**	**–**	**(15)**	**–**	**(15)**	**–**	**(15)**
Profit (loss) before tax	**1,651**	**168**	**750**	**918**	**1,257**	**(333)**	**3,493**	**–**	**3,493**
Year ended 31 December 2003*									
Net interest income	3,137	38	43	81	1,875	(349)	4,744	511	5,255
Other finance income	–	–	–	–	–	34	34	–	34
Other operating income	1,533	505	579	1,084	1,561	299	4,477	142	4,619
Total income	4,670	543	622	1,165	3,436	(16)	9,255	653	9,908
Operating expenses	(2,583)	(141)	(120)	(261)	(2,048)	(9)	(4,901)	(272)	(5,173)
Trading surplus (deficit)	2,087	402	502	904	1,388	(25)	4,354	381	4,735
General insurance claims	–	(236)	–	(236)	–	–	(236)	–	(236)
Provisions for bad and doubtful debts	(594)	–	–	–	(306)	13	(887)	(63)	(950)
Amounts written off fixed asset investments	–	–	–	–	(44)	–	(44)	–	(44)
Share of results of joint ventures	(22)	–	–	–	–	–	(22)	–	(22)
Profit on sale of businesses	–	–	–	–	–	–	–	865	865
Profit (loss) before tax	1,471	166	502	668	1,038	(12)	3,165	1,183	4,348
Year ended 31 December 2002*									
Net interest income	2,890	38	36	74	1,970	(251)	4,683	488	5,171
Other finance income	–	–	–	–	–	165	165	–	165
Other operating income	1,567	353	(157)	196	1,520	149	3,432	119	3,551
Total income	4,457	391	(121)	270	3,490	63	8,280	607	8,887
Operating expenses	(2,402)	(105)	(186)	(291)	(1,939)	(4)	(4,636)	(277)	(4,913)
Trading surplus	2,055	286	(307)	(21)	1,551	59	3,644	330	3,974
General insurance claims	–	(229)	–	(229)	–	–	(229)	–	(229)
Provisions for bad and doubtful debts	(496)	–	–	–	(489)	7	(978)	(51)	(1,029)
Amounts written off fixed asset investments	–	–	–	–	(57)	(30)	(87)	–	(87)
Share of results of joint ventures	(11)	–	–	–	–	–	(11)	–	(11)
Profit (loss) before tax	1,548	57	(307)	(250)	1,005	36	2,339	279	2,618

2 Segmental analysis (continued)

Geographical area:**	**Domestic 2004 £m**	**International 2004 £m**	**Total 2004 £m**	Domestic 2003 £m	International 2003 £m	Continuing operations 2003 £m	Discontinued operations§ 2003 £m	Total 2003 £m
Interest receivable	**9,992**	**403**	**10,395**	8,490	383	8,873	1,276	10,149
Other finance income	**39**	**–**	**39**	34	–	34	–	34
Fees and commissions receivable	**2,980**	**144**	**3,124**	2,831	156	2,987	112	3,099
Dealing profits (before expenses)	**249**	**22**	**271**	276	249	525	35	560
Income from long-term assurance business	**715**	**–**	**715**	436	–	436	17	453
General insurance premium income	**554**	**–**	**554**	535	–	535	–	535
Other operating income	**682**	**6**	**688**	677	5	682	12	694
Total gross income	**15,211**	**575**	**15,786**	13,279	793	14,072	1,452	15,524
Profit on ordinary activities before tax	**3,295**	**198**	**3,493**	2,810	355	3,165	1,183	4,348

Geographical area**	Domestic 2002 £m	International 2002 £m	Continuing operations 2002 £m	Discontinued operations§ 2002 £m	Total 2002 £m
Interest receivable	8,226	582	8,808	1,741	10,549
Other finance income	165	–	165	–	165
Fees and commissions receivable	2,773	169	2,942	111	3,053
Dealing profits (before expenses)	125	39	164	24	188
Income from long-term assurance business	(305)	–	(305)	11	(294)
General insurance premium income	486	–	486	–	486
Other operating income	552	207	759	4	763
Total gross income	12,022	997	13,019	1,891	14,910
Profit on ordinary activities before tax	2,122	217	2,339	279	2,618

	Net Assets† 2004 £m	Net Assets† 2003 £m	**Assets‡ 2004 £m**	Assets‡ 2003 £m
Class of business				
UK Retail Banking	**2,991**	2,555	**101,615**	90,541
Insurance and Investments:				
General insurance	**427**	470	**1,084**	1,009
Life, pensions, unit trusts and asset management	**6,908**	6,531	**9,141**	8,835
	7,335	7,001	**10,225**	9,844
Wholesale and International Banking	**4,469**	4,390	**112,968**	101,286
Central group items	**(4,772)**	(4,278)	**271**	263
	10,023	9,668	**225,079**	201,934
Geographical area**				
Domestic	**9,369**	9,069	**212,197**	189,162
International	**654**	599	**12,882**	12,772
	10,023	9,668	**225,079**	201,934

* From the beginning of 2004 the Group changed its UK branch and other distribution networks from cost centres to profit centres and, consequently, amended the internal commission arrangements between these networks and the insurance product manufacturing businesses within the Group. The effect of this change has been to redistribute income from the insurance segments to UK Retail Banking and, to a lesser extent, to Wholesale. In addition, certain costs previously included in Central group items were reallocated to the operating segments. The 2002 and 2003 segmental analyses have been restated to reflect these changes on a consistent basis.

** The geographical distribution of gross income sources, profit on ordinary activities before tax and assets by domestic and international operations is based on the location of the office recording the transaction, except for lending by the international business booked in London.

† Net assets represent shareholders' funds plus equity minority interests. Disclosure of information on net assets is an accounting standard requirement (SSAP 25); it is not appropriate to relate it directly to the segmental profits above because the business is not managed by the allocation of net assets to business units.

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

§ Discontinued operations related entirely to the international operations of the Wholesale and International Banking segment.

As the business of the Group is mainly that of banking and insurance, no segmental analysis of turnover is given.

3 Dealing profits (before expenses)

	2004 £m	2003 £m	2002 £m
Foreign exchange trading income	**178**	228	173
Securities and other gains	**93**	332	15
	271	560	188

Dealing profits include the profits and losses arising both on the purchase and sale of trading instruments and from the year-end revaluation to market value, together with the interest income earned from these instruments and the related funding cost.

4 Administrative expenses

	2004 £m	2003 £m	2002 £m
Salaries	**2,069**	2,092	2,065
Social security costs	**140**	143	134
Other pension costs (note 45)	**338**	353	318
Staff costs	**2,547**	2,588	2,517
Other administrative expenses	**1,737**	1,888	1,695
	4,284	4,476	4,212
The average number of persons on a headcount basis employed by the Group during the year was as follows:			
UK	**74,924**	73,814	71,134
Overseas	**3,372**	10,288	11,491
	78,296	84,102	82,625

The above staff numbers exclude 4,657 (2003: 5,202; 2002: 5,870) staff employed in the long-term assurance business. Costs of £190 million (2003: £194 million; 2002: £209 million) in relation to those staff are reflected in the valuation of the long-term assurance business.

Details of directors' emoluments, pensions and interests are given on pages 84 to 89.

	2004 £m	2003 £m	2002 £m
Statutory audit	**5.2**	5.5	4.8
Other audit related fees:			
– Audit related regulatory reporting	**0.9**	0.9	0.9
– Further assurance services	**6.4**	3.3	1.7
Total other audit related fees	**7.3**	4.2	2.6
Audit and audit related fees	**12.5**	9.7	7.4
Tax advisory	**0.8**	1.6	0.7
Other non-audit fees:			
– Due diligence services	**0.9**	0.7	0.8
– Management consultancy	**–**	–	0.1
– Other	**0.3**	0.2	0.7
Total other non-audit fees	**1.2**	0.9	1.6
Total fees	**14.5**	12.2	9.7

During the year the auditors also earned fees of £0.6 million (2003: £0.6 million; 2002: £0.8 million) in respect of the audit of unit trusts and pension schemes managed by the Group.

Included in 'Other audit related fees' are the costs of the advice provided in relation to the Group's preparations for the implementation of International Financial Reporting Standards and the requirements of the Sarbanes-Oxley Act together with the costs of the audit of the Group's Form 20-F filing.

It is the Group's policy to use the auditors on assignments in cases where their knowledge of the Group means that it is neither efficient nor cost effective to employ another firm of accountants. Such assignments typically relate to the provision of advice on tax issues, assistance in transactions involving the acquisition and disposal of businesses and accounting advice. The auditors are not permitted to provide management consultancy services to the Group.

4 Administrative expenses (continued)

The Group has procedures to ensure that fees for audit and non-audit services are approved in advance. The audit committee has established de minimis fee limits for particular detailed types of service and has approved in advance all non-audit assignments where the fee falls below the relevant limit. All statutory audit work as well as non-audit assignments where the fee is expected to exceed the relevant limit are subject to individual pre-approval by the audit committee. On a quarterly basis, the audit committee receives a report detailing all pre-approved services and amounts paid to the auditors for such pre-approved services.

5 Amounts written off fixed asset investments

	2004 **£m**	2003 £m	2002 £m
Debt securities	**43**	42	84
Equity shares	**9**	2	3
	52	44	87

6 (Loss) profit before tax on sale of businesses

	2004 **£m**	2003 £m	2002 £m
Profit on sale of businesses in Argentina (tax: £6 million)	**6**	–	–
Loss on sale of businesses in Colombia (after charging £3 million of goodwill previously written off to reserves) (tax: nil)	**(20)**	–	–
Loss on sale of businesses in Panama, Guatemala and Honduras (tax: £1 million)	**(1)**	–	–
Loss on sale of French fund management and private banking businesses (tax: nil)	**–**	(15)	–
Loss on sale of Brazilian businesses (after charging £161 million of goodwill previously written off to reserves) (tax: nil)	**–**	(41)	–
Profit on sale of New Zealand operations (after charging £20 million of goodwill previously written off to reserves) (tax: nil)	**–**	921	–
	(15)	865	–

During 2004 the Group completed the sale, announced on 19 July 2004 and completed on 19 November 2004, of the business of the branch of Lloyds TSB Bank plc in Argentina; the sale, announced on 19 July 2004 and completed on 30 November 2004 of the Group’s principal businesses in Colombia comprising its interests in Lloyds TSB Bank S.A. and in Lloyds Trust S.A. and certain offshore assets; and the sales, announced on 1 December 2003, of substantially all of the businesses of the branches of Lloyds TSB Bank plc in Panama, Guatemala and Honduras which were completed on 30 April 2004, 4 June 2004 and 1 October 2004 respectively.

During 2003 the Group completed the sales of its French fund management and private banking businesses, including its subsidiaries Lloyds Bank SA, Chaillot Assurances SA and Capucines Investissements SA; its Brazilian subsidiaries Banco Lloyds TSB S.A. and Losango Promotora de Vendas Ltda, together with substantially all of the business of the Brazilian branch of Lloyds TSB Bank plc and certain offshore Brazilian assets; and its subsidiary, NBNZ Holdings Limited, comprising the Group’s New Zealand banking and insurance operations.

The trading results of the businesses sold in 2004 were not material to the Group. Discontinued operations in 2002 and 2003 comprise the businesses in New Zealand, Brazil and France sold in 2003.

7 Analysis of comparative profit and loss account for the year ended 31 December 2002

The analysis of the profit and loss account for the year ended 31 December 2002 between continuing and discontinued operations is set out below. Discontinued operations comprise the operations in France, New Zealand and Brazil sold in 2003; for further details see note 6.

	Continuing Operations 2002 £m	Discontinued Operations 2002 £m	Total 2002 £m
Interest receivable:			
– Interest receivable and similar income arising from debt securities	523	44	567
– Other interest receivable and similar income	8,285	1,697	9,982
Interest payable	4,125	1,253	5,378
Net interest income	4,683	488	5,171
Other finance income	165	–	165
Other income:			
Fees and commissions receivable	2,942	111	3,053
Fees and commissions payable	(614)	(31)	(645)
Dealing profits (before expenses)	164	24	188
Income from long-term assurance business	(305)	11	(294)
General insurance premium income	486	–	486
Other operating income	759	4	763
	3,432	119	3,551
Total income	8,280	607	8,887
Operating expenses:			
Administrative expenses	3,973	239	4,212
Depreciation and amortisation	663	38	701
Total operating expenses	4,636	277	4,913
Trading surplus	3,644	330	3,974
General insurance claims	229	–	229
Provisions for bad and doubtful debts:			
Specific	914	51	965
General	64	–	64
	978	51	1,029
Amounts written off fixed asset investments	87	–	87
Operating profit	2,350	279	2,629
Share of results of joint ventures	(11)	–	(11)
Profit on ordinary activities before tax	2,339	279	2,618

8 Profit on ordinary activities before tax

	2004 £m	2003 £m	2002 £m
Profit on ordinary activities before tax is stated after taking account of:			
Income from:			
Aggregate amounts receivable, including capital repayments, in respect of assets leased to customers and banks under:			
– Finance leases and hire purchase contracts	**3,742**	3,495	3,290
– Operating leases	**422**	446	440
Profits less losses on disposal of investment securities	**126**	47	160
Charges:			
Rental of premises	**212**	220	220
Hire of equipment	**17**	18	18
Interest on subordinated liabilities (loan capital)	**601**	622	537

9 Tax on profit on ordinary activities

a Analysis of charge for the year

	2004 £m	2003 £m	2002 £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
	1,004	1,025	766

The charge for tax on the profit for the year is based on a UK corporation tax rate of 30 per cent (2003: 30 per cent; 2002: 30 per cent).

In addition to the tax charge in the profit and loss account detailed above, £71 million (2003: £2 million; 2002: £968 million) of deferred tax has been credited to the statement of total recognised gains and losses in respect of actuarial losses recognised in post-retirement benefit schemes (note 45).

b Factors affecting the tax charge for the year

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to profit before tax to the current tax charge and total tax charge for the year is given below:

	2004 £m	2003 £m	2002 £m
Profit on ordinary activities before tax	**3,493**	4,348	2,618
Tax charge thereon at UK corporation tax rate of 30%	**1,048**	1,304	785
Factors affecting charge:			
– Goodwill amortisation	**9**	9	9
– Overseas tax rate differences	**(14)**	(9)	24
– Specifically allowable, unallowable and non-taxable items	**(5)**	(10)	(28)
– Net tax effect of disposals	**(12)**	(276)	(23)
– Tax deductible coupons on non-equity minority interests	**(12)**	(12)	(12)
– Payments to employee trust	**–**	–	(20)
– Capital allowances in excess of depreciation	**(86)**	(105)	7
– Other timing differences	**(60)**	(14)	99
– Life companies rate differences	**(16)**	16	43
– Other items	**7**	10	(14)
Current tax charge	**859**	913	870
Deferred tax:			
– Capital allowances in excess of depreciation	**86**	105	(7)
– Other timing differences	**60**	14	(99)
Associated undertakings and joint ventures	**(1)**	(7)	2
Tax on profit on ordinary activities	**1,004**	1,025	766
Effective rate	**28.7%**	23.6%	29.3%

9 Tax on profit on ordinary activities (continued)

c Factors that may affect the future tax charge

The current tax charge includes a charge of £199 million (2003: charge of £157 million; 2002: credit of £44 million) in respect of notional tax on the shareholder's interest in the movement in value of the long-term assurance business (note 29b). Since this derives from the use of a combination of tax rates it can give rise to a higher or lower charge compared to an expected 30 per cent rate.

Future transfers from Scottish Widows plc's long-term business fund to its shareholder's fund will be subject to a shareholder tax charge. Under FRS 19, no provision is required to be made since the timing of such transfers is under Scottish Widows plc's control. The potential deferred tax liability (undiscounted) not recognised on the balance sheet is approximately £230 million (2003: £110 million).

10 Ordinary dividends

	2004 pence per share	2003 pence per share	2002 pence per share	**2004 £m**	2003 £m	2002 £m
Interim: paid	**10.7**	10.7	10.7	**599**	597	597
Final: proposed	**23.5**	23.5	23.5	**1,315**	1,314	1,311
	34.2	34.2	34.2	**1,914**	1,911	1,908

No dividends were paid in 2004 on the £100 of 6 per cent non-cumulative redeemable preference shares issued in the year (see note 40). Dividends are being accrued at the rate of 6 per cent per annum and the first payment was made in March 2005.

11 Earnings per share

	2004	2003	2002
Profit attributable to shareholders†	**£2,421m**	£3,254m	£1,790m
Weighted average number of ordinary shares in issue during the year‡	**5,590m**	5,581m	5,570m
Dilutive effect of options outstanding	**35m**	18m	27m
Diluted weighted average number of ordinary shares in issue during the year	**5,625m**	5,599m	5,597m
Earnings per share	**43.3p**	58.3p	32.1p
Diluted earnings per share	**43.0p**	58.1p	32.0p

† No adjustment was made to profit attributable to shareholders in calculating diluted earnings per share.

‡ The weighted average number of shares for the year has been calculated after deducting 6 million (2003: 8 million; 2002: 5 million) ordinary shares representing the Group's holdings of own shares (note 43).

12 Treasury bills and other eligible bills

	2004 Balance sheet £m	2004 Valuation £m	2003 Balance sheet £m	2003 Valuation £m
Investment securities:				
Treasury bills and similar securities	**75**	**77**	308	305
Other eligible bills	**13**	**13**	222	218
	88	**90**	530	523
Other securities:				
Treasury bills and similar securities	**4**	**4**	9	9
	92	**94**	539	532
Geographical analysis by issuer:				
United Kingdom	**–**		336	
Latin America	**18**		70	
Other	**74**		133	
	92		539	
Included above: Unamortised discounts net of premiums on investment securities	**–**		2	

	Cost £m	Premiums and discounts £m	Total £m
Movements in investment securities:			
At 1 January 2004	**528**	**2**	**530**
Exchange and other adjustments	**(3)**	**–**	**(3)**
Additions	**430**	**–**	**430**
Bills sold or matured	**(830)**	**(5)**	**(835)**
Adjustments on disposal of businesses	**(37)**	**–**	**(37)**
Amortisation of premiums and discounts	**–**	**3**	**3**
At 31 December 2004	**88**	**–**	**88**

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. It is expected that tax of £1 million would be payable (2003: £2 million recoverable) if the investment securities were sold at their year end valuation.

The difference between the cost of other securities and market value, where the market value is higher than the cost, is not disclosed as its determination is not practicable.

13 Loans and advances to banks

	2004 £m	2003 £m
Lending to banks	**2,483**	2,292
Deposits placed with banks	**21,083**	13,273
Total loans and advances to banks	**23,566**	15,565
Provisions for bad and doubtful debts	**(1)**	(18)
	23,565	15,547
Repayable on demand	**2,477**	3,768
Other loans and advances by residual maturity repayable:		
– 3 months or less	**16,763**	7,637
– 1 year or less but over 3 months	**2,243**	2,329
– 5 years or less but over 1 year	**1,422**	1,496
– Over 5 years	**661**	335
Provisions for bad and doubtful debts	**(1)**	(18)
	23,565	15,547

14 Loans and advances to customers

	2004 £m	2003 £m
Lending to customers	**144,708**	125,785
Hire purchase debtors	**4,828**	4,701
Equipment leased to customers	**6,387**	6,470
Total loans and advances to customers	**155,923**	136,956
Provisions for bad and doubtful debts	**(1,662)**	(1,677)
Interest held in suspense	**(21)**	(28)
	154,240	135,251
Loans and advances by residual maturity repayable:		
– 3 months or less	**28,748**	23,284
– 1 year or less but over 3 months	**9,878**	9,458
– 5 years or less but over 1 year	**35,301**	31,384
– Over 5 years	**81,996**	72,830
Provisions for bad and doubtful debts	**(1,662)**	(1,677)
Interest held in suspense	**(21)**	(28)
	154,240	135,251
Of which repayable on demand or at short notice	**15,805**	13,365

The cost of assets acquired during the year for letting to customers under finance leases and hire purchase contracts amounted to £5,472 million (2003: £4,478 million).

Equipment leased to customers, which is stated after deducting £4,551 million (2003: £4,907 million) of unearned charges, is repayable as follows:

	2004 £m	2003 £m
3 months or less	**247**	91
1 year or less but over 3 months	**282**	345
5 years or less but over 1 year	**1,516**	1,465
Over 5 years	**4,342**	4,569
	6,387	6,470

15 Provisions for bad and doubtful debts and non-performing lending

	2004 Specific £m	2004 General £m	2003 Specific £m	2003 General £m	2002 Specific £m	2002 General £m
At 1 January	**1,313**	**382**	1,334	433	1,099	369
Exchange and other adjustments	**(11)**	**–**	(1)	–	(55)	(3)
Adjustments on acquisitions and disposals	**(21)**	**(12)**	(49)	(5)	–	3
Transfer from general to specific provisions	**3**	**(3)**	50	(50)	–	–
Advances written off	**(1,028)**	**–**	(1,145)	–	(878)	–
Recoveries of advances written off in previous years	**174**	**–**	178	–	203	–
Charge (release) to profit and loss account:						
New and additional provisions	**1,571**	**12**	1,552	9	1,544	64
Releases and recoveries	**(618)**	**(99)**	(606)	(5)	(579)	–
	953	**(87)**	946	4	965	64
At 31 December	**1,383**	**280**	1,313	382	1,334	433

	2004 £m	2003 £m	2002 £m
	1,663	1,695	1,767
In respect of:			
Loans and advances to banks	**1**	18	1
Loans and advances to customers	**1,662**	1,677	1,766
	1,663	1,695	1,767

	2004 £m	2003 £m
Non-performing lending comprises:		
Accruing loans on which interest is being placed in suspense	**567**	633
Loans accounted for on a non-accrual basis	**673**	585
	1,240	1,218
Provisions	**(914)**	(916)
Interest held in suspense	**(21)**	(28)
	305	274

16 Concentrations of exposure

	2004 **£m**	2003 £m
Loans and advances to customers		
Domestic		
Agriculture, forestry and fishing	**2,076**	2,025
Manufacturing	**3,292**	3,211
Construction	**1,877**	1,497
Transport, distribution and hotels	**6,753**	4,741
Property companies	**5,775**	4,577
Financial, business and other services	**12,103**	9,652
Personal:		
– Mortgages	**80,065**	70,750
– Other	**22,833**	20,139
Lease financing	**6,387**	6,470
Hire purchase	**4,828**	4,701
Other	**5,321**	3,351
Total domestic	**151,310**	131,114
International		
Latin America	**125**	557
USA	**2,385**	2,681
Europe	**1,587**	1,981
Rest of the world	**516**	623
Total international	**4,613**	5,842
	155,923	136,956
Provisions for bad and doubtful debts*	**(1,662)**	(1,677)
Interest held in suspense*	**(21)**	(28)
	154,240	135,251

* Figures exclude provisions and interest held in suspense relating to loans and advances to banks.

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

17 Debt securities

	2004 Balance sheet £m	2004 Valuation £m	2003 Balance sheet £m	2003 Valuation £m
Investment securities				
Government securities	**2,211**	**2,213**	1,895	1,902
Bank and building society certificates of deposit	**1,901**	**1,902**	2,515	2,515
Corporate debt securities	**2,581**	**2,587**	1,895	1,890
Mortgage backed securities	**2,774**	**2,781**	2,211	2,212
Other asset backed securities	**3,761**	**3,756**	3,942	3,951
Other debt securities	**1,140**	**1,141**	1,283	1,284
	14,368	**14,380**	13,741	13,754
Other securities				
Government securities	**4,524**	**4,524**	7,253	7,253
Other public sector securities	**51**	**51**	106	106
Corporate debt securities	**5,733**	**5,733**	6,785	6,785
Mortgage backed securities	**504**	**504**	664	664
Other asset backed securities	**14**	**14**	120	120
	25,194	**25,206**	28,669	28,682
Due within 1 year	**4,090**		5,045	
Due 1 year and over	**21,104**		23,624	
	25,194		28,669	
Geographical analysis by issuer				
United Kingdom	**5,048**		5,232	
Other European	**11,825**		15,949	
North America and Caribbean	**5,080**		5,130	
Latin America	**76**		98	
Asia Pacific	**2,763**		1,994	
Other	**402**		266	
	25,194		28,669	
Unamortised discounts net of premiums on investment securities	**56**		341	
Investment securities				
Listed	**8,925**	**8,931**	8,162	8,173
Unlisted	**5,443**	**5,449**	5,579	5,581
	14,368	**14,380**	13,741	13,754
Other securities				
Listed	**10,378**	**10,378**	14,374	14,374
Unlisted	**448**	**448**	554	554
	10,826	**10,826**	14,928	14,928

17 Debt securities (continued)

	Cost £m	Premiums and discounts £m	Provisions £m	Total £m
Movements in investment securities:				
At 1 January 2004	**13,731**	**109**	**99**	**13,741**
Exchange and other adjustments	**(484)**	**–**	**(2)**	**(482)**
Additions	**9,637**	**–**	**–**	**9,637**
Transfers from other securities	**281**	**–**	**–**	**281**
Securities sold or matured	**(8,787)**	**(2)**	**(25)**	**(8,764)**
Adjustments on disposal of businesses	**(23)**	**–**	**(7)**	**(16)**
Charge for the year	**–**	**–**	**43**	**(43)**
Amortisation of premiums and discounts	**–**	**14**	**–**	**14**
At 31 December 2004	**14,355**	**121**	**108**	**14,368**

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. It is expected that tax of £4 million (2003: £3 million) would be payable if the investment securities were sold at their year end valuation.

The difference between the cost of other securities and market value, where the market value is higher than the cost, is not disclosed as its determination is not practicable.

18 Equity shares

	2004 Balance sheet £m	**2004 Valuation £m**	2003 Balance sheet £m	2003 Valuation £m
Investment securities				
Listed	**5**	**7**	5	5
Unlisted	**34**	**56**	30	126
	39	**63**	35	131
Other securities				
Listed	**176**	**176**	423	423
	215	**239**	458	554

	Cost £m	Provisions £m	Total £m
Movements in investment securities:			
At 1 January 2004	**41**	**6**	**35**
Exchange and other adjustments	**(1)**	**(1)**	**–**
Additions	**21**	**–**	**21**
Disposals	**(12)**	**(5)**	**(7)**
Adjustments on disposal of businesses	**(1)**	**–**	**(1)**
Charge for the year	**–**	**9**	**(9)**
At 31 December 2004	**48**	**9**	**39**

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. If the investment securities were sold at their year end valuation no tax is expected to be payable as any such gains would be exempt or covered by available capital losses.

The difference between the cost of other securities and market value, where the market value is higher than the cost, is not disclosed as its determination is not practicable.

19 Assets transferred under sale and repurchase transactions

	2004 £m	2003 £m
Assets subject to sale and repurchase agreements:		
Treasury bills and other eligible bills	**117**	136
Debt securities	**10,454**	4,503
	10,571	4,639

These investments have been sold to third parties but the Group is committed to reacquire them at a future date and at a predetermined price. At 31 December 2004 the Group held £12,783 million (2003: £2,643 million) of securities as collateral under reverse repurchase agreements. The above disclosure includes assets held through these agreements and subsequently resold as collateral for the Group’s own transactions.

20 Interests in joint ventures

	£m
At 1 January 2004	**54**
Share of losses	**(1)**
At 31 December 2004	**53**

The Group’s largest investments are in two joint ventures:

	Group interest	Nature of business
iPSL	19.5% of issued ordinary share capital	Cheque processing
GF Two Limited (formerly Goldfish Holdings Limited)	25.0% of issued ordinary share capital	No longer trading

In the year ended 31 December 2004 £16 million (2003: £25 million; 2002: £31 million) of fees payable to iPSL have been included in the Group’s administrative expenses and £3 million (2003: £3 million; 2002: £6 million) of charges to iPSL have been included in the Group’s income. The Group has also prepaid £17 million (2003: £13 million) of fees in respect of 2005 and this amount is included in prepayments and accrued income.

GF One Limited (formerly Goldfish Bank Limited, a wholly owned subsidiary of GF Two Limited) has lent £44 million (2003: nil) to the Group and this amount is included in customer accounts. Interest payable to GF One Limited of £1 million (2003: nil) has been charged to the Group’s profit and loss account and capitalised in this balance.

In the year ended 31 December 2003 £7 million (2002: £25 million) of interest receivable from GF One Limited and £6 million (2002: £12 million) of charges to GF One Limited in respect of administrative costs were included in the Group’s income.

Included in the gross assets disclosed on the balance sheet is an investment of £3 million (2003: £3 million) in associated undertakings.

21 Interests in group undertakings

The principal group undertakings, all of which have prepared accounts to 31 December and whose results are included in the consolidated accounts of Lloyds TSB Group plc, are:

	Country of registration/ incorporation	Percentage of equity share capital and voting rights held	Nature of business
Lloyds TSB Bank plc	England	100%	Banking and financial services
Cheltenham & Gloucester plc	England	100%†	Mortgage lending and retail investments
Lloyds TSB Commercial Finance Limited	England	100%†	Credit factoring
Lloyds TSB Leasing Limited	England	100%†	Financial leasing
Lloyds TSB Private Banking Limited	England	100%†	Private banking
The Agricultural Mortgage Corporation PLC	England	100%†	Long-term agricultural finance
Lloyds TSB Offshore Limited	Jersey	100%†	Banking and financial services
Lloyds TSB Scotland plc	Scotland	100%†	Banking and financial services
Lloyds TSB General Insurance Limited	England	100%†	General insurance
Scottish Widows Investment Partnership Group Limited	England	100%†	Investment management
Abbey Life Assurance Company Limited	England	100%†	Life assurance
Lloyds TSB Insurance Services Limited	England	100%†	Insurance broking
Lloyds TSB Asset Finance Division Limited	England	100%†	Consumer credit, leasing and related services
Black Horse Limited	England	100%†	Consumer credit, leasing and related services
Scottish Widows plc	Scotland	100%†	Life assurance
Scottish Widows Annuities Limited	Scotland	100%†	Life assurance

† Indirect interest

The country of registration/incorporation is also the principal area of operation for each of the above group undertakings except as follows:

Lloyds TSB Bank plc operates principally in the UK but also through branches in Belgium, Dubai, Ecuador, Gibraltar, Hong Kong, Japan, Luxembourg, Malaysia, Monaco, Netherlands, Paraguay, Singapore, Spain, Switzerland, Uruguay, the USA and a representative office in Iran.

22 Quasi-subsidiaries

The Group has interests in a number of entities which, although they do not meet the legal definition of a subsidiary, give rise to benefits that are in substance no different from those that would arise if those entities were subsidiaries. As a consequence, these entities are consolidated in the same way as if they were subsidiaries.

The primary financial statements of these entities can be summarised as follows:

	Equipment leasing vehicles			Structured finance vehicles		
	2004 £m	2003 £m	2002 £m	**2004 £m**	2003 £m	2002 £m
Profit and loss account						
Interest receivable	**–**	–	–	**132**	82	12
Interest payable	**(74)**	(59)	(55)	**(83)**	(52)	(4)
Other operating income	**116**	93	80	**(8)**	(2)	–
Total income	**42**	34	25	**41**	28	8
Operating expenses	**(57)**	(36)	(24)	**–**	–	–
(Loss) profit on ordinary activities before taxation	**(15)**	(2)	1	**41**	28	8
Tax on (loss) profit on ordinary activities	**5**	6	5	**(5)**	(2)	–
(Loss) profit on ordinary activities after taxation	**(10)**	4	6	**36**	26	8
Dividends paid	**–**	–	–	**(24)**	_	–
(Loss) profit for the year	**(10)**	4	6	**12**	26	8
Balance sheet						
Assets:						
Loans and advances to customers	**–**	–		**410**	345	
Debt securities	**–**	–		**3,770**	3,718	
Tangible fixed assets	**1,742**	1,408		**–**	–	
Other assets and prepayments	**49**	23		**36**	34	
Total assets	**1,791**	1,431		**4,216**	4,097	
Liabilities:						
Deposits by banks	**1,527**	1,309		**–**	672	
Debt securities in issue	**–**	–		**3,272**	3,123	
Other liabilities and accruals	**260**	108		**31**	18	
Shareholders’ funds	**4**	14		**913**	284	
Total liabilities	**1,791**	1,431		**4,216**	4,097	
Cash flow statement						
Net cash inflow (outflow) from operating activities	**388**	132	422	**52**	1,173	(250)

23 Intangible fixed assets

	Cost £m	Amortisation £m	Ne book value £m
Goodwill			
At 1 January 2004	**2,626**	**113**	**2,513**
Acquisition adjustment	**(34)**	**–**	**(34)**
Adjustments on disposal of businesses	**(14)**	**(4)**	**(10)**
Charge for the year	**–**	**44**	**(44)**
At 31 December 2004	**2,578**	**153**	**2,425**

24 Tangible fixed assets

	Premises £m	Equipment £m	Operating lease assets £m
Cost:			
At 1 January 2004	**1,192**	**2,186**	**2,518**
Exchange and other adjustments	**–**	**(1)**	**(46)**
Adjustments on disposal of businesses	**(10)**	**(13)**	**–**
Additions	**73**	**262**	**801**
Disposals	**(18)**	**(109)**	**(471)**
At 31 December 2004	**1,237**	**2,325**	**2,802**
Depreciation:			
At 1 January 2004	**416**	**1,296**	**266**
Exchange and other adjustments	**–**	**(1)**	**(4)**
Adjustments on disposal of businesses	**(4)**	**(8)**	**–**
Charge for the year (£589 million in total; 2003: £646 million; 2002: £642 million)	**66**	**257**	**266**
Disposals	**(5)**	**(81)**	**(281)**
At 31 December 2004	**473**	**1,463**	**247**
Balance sheet amount at 31 December 2004	**764**	**862**	**2,555**
		4,181	
Balance sheet amount at 31 December 2003	776	890	2,252
		3,918	

	2004 £m	2003 £m
Balance sheet amount of premises comprises:		
Freeholds	**349**	369
Leaseholds 50 years and over unexpired	**140**	133
Leaseholds less than 50 years unexpired	**275**	274
	764	776
Land and buildings occupied for own activities	**695**	705

The Group’s residual value exposure in respect of operating lease assets, all of which are expected to be disposed of at the end of the lease terms, was as follows:

	2004 £m	2003 £m
Residual value expected to be recovered in:		
1 year or less	**378**	181
2 years or less but over 1 year	**128**	330
5 years or less but over 2 years	**647**	505
Over 5 years	**588**	445
Total exposure	**1,741**	1,461

25 Lease commitments

At 31 December 2004, the Group was committed to various non-cancellable operating leases, which require aggregate future rental payments as follows:

	Premises £m
Payable within one year	**208**
1 to 2 years	**201**
2 to 3 years	**196**
3 to 4 years	**191**
4 to 5 years	**185**
Over 5 years	**342**
	1,323

Annual commitments under non-cancellable operating lease agreements were:

	2004 Premises £m	**2004 Equipment £m**	2003 Premises £m	2003 Equipment £m
Leases on which the commitment is due to expire in:				
1 year or less	**6**	–	7	–
5 years or less but over 1 year	**26**	–	29	–
Over 5 years	**176**	–	190	–
	208	–	226	–

Obligations under finance leases were:

	2004 Premises £m	**2004 Equipment £m**	2003 Premises £m	2003 Equipment £m
Amounts payable in:				
1 year or less	**1**	**1**	–	–
5 years or less but over 1 year	**3**	**1**	–	–
	4	**2**	–	–

26 Capital commitments

Capital expenditure contracted but not provided for at 31 December 2004 amounted to £150 million (2003: £77 million) of which £146 million (2003: £71 million) relates to assets to be leased to customers under operating leases.

27 Other assets

	2004 £m	2003 £m
Balances arising from derivatives used for trading purposes (note 47a)	**2,015**	2,489
Balances arising from derivatives used for hedging purposes	**254**	475
Settlement balances	**40**	54
Other assets	**911**	926
	3,220	3,944

28 Prepayments and accrued income

	2004 £m	2003 £m
Interest receivable	**1,075**	869
Deferred expenditure incurred under cash gift and discount mortgage schemes	**78**	128
Other debtors and prepayments	**1,420**	921
	2,573	1,918

29 Long-term assurance business
a Analysis of embedded value

	2004 **£m**	2003 £m
The embedded value included in the consolidated balance sheet comprises:		
Net tangible assets of life companies including surplus	**3,842**	3,602
Value of other shareholder's interests in the long-term assurance business	**2,939**	2,879
	6,781	6,481

	2004 **£m**	2003 £m
Movements in the embedded value balance:		
At 1 January	**6,481**	6,213
Exchange and other adjustments	**(16)**	12
Profit after tax	**516**	296
Adjustments on disposal of businesses	**–**	(38)
Dividends	**(200)**	(2)
At 31 December	**6,781**	6,481

b Analysis of income from long-term assurance business

Income from long-term assurance business included in the profit and loss account can be divided into those items comprising the operating profit of the business and other items. Included within operating profit are the following items:

New business contribution. This represents the value recognised at the end of the year from new business written during the year after taking into account the cost of establishing technical provisions and reserves, less the costs of acquiring the business, including commissions paid to independent financial advisers and other direct sales costs.

Contribution from 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 the year;
- Experience variances caused by the 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
- Customer remediation provisions (see c).

Development costs. This represents the costs associated with new product development and implementation of the bancassurance strategy.

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.

Operating profit is adjusted by the following items to arrive at income from long-term assurance business:

Investment variance: this represents (a) 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; (b) the effect of these fluctuations on the value of in-force business; and (c) other effects of changes in extraneous economic circumstances beyond the control of management.

Changes in economic assumptions: this represents the effect of changes in the economic assumptions referred to in e.

29 Long-term assurance business (continued)

	2004 £m	2003 £m	2002 £m
Income from long-term assurance business:			
New business contribution	**225**	150	136
Existing business:			
Expected return	**289**	264	312
Experience variances	**(41)**	(16)	(1)
Assumption changes and other items	**(39)**	(75)	78
Customer remediation provisions (see c)	**(12)**	(100)	(205)
	197	73	184
Development costs	**(11)**	(13)	–
Investment earnings	**167**	153	214
Operating profit	**578**	363	534
Investment variance	**139**	112	(883)
Changes in economic assumptions (see e)	**(2)**	(22)	55
Income from long-term assurance business before tax	**715**	453	(294)
Attributed tax	**(199)**	(157)	44
Income from long-term assurance business after tax	**516**	296	(250)

This analysis details the components of embedded value income for 2004 and the comparative periods. These numbers are not comparable in all respects to the analysis of life and pensions profitability given on page 30, in the operating and financial review, since that analysis includes certain items which are accounted for outside of the embedded value calculations. In addition, comparatives in the operating and financial review have been restated to reflect the impact of the introduction, in 2004, of the management of the Group's distribution channels as profit centres.

c Customer remediation provisions

Redress to past purchasers of pension policies

Following an industry wide investigation in the 1990's it was concluded that a large number of customers who had purchased personal pension products had been poorly advised by insurance companies and intermediaries; an action plan was established requiring the UK pensions industry to review all cases of possible misselling and, where appropriate, pay compensation. As the review of pension cases in the Group has progressed, provisions have been established for the estimated cost of compensation.

	2004 £m	2003 £m	2002 £m
Movements in the provision over the last three years:			
At 1 January	**25**	37	203
Accrual of interest on the provision	**–**	2	17
Charge for the year	**–**	44	40
Compensation paid	**(12)**	(58)	(223)
At 31 December	**13**	25	37

The review is now nearing completion and management do not expect any further material changes in the provisioning requirement.

29 Long-term assurance business (continued)

Mortgage endowments and other savings products

During 2002, a review was carried out in conjunction with the FSA into sales of mortgage endowment and other long-term savings products made by the Abbey Life sales force between 1988 and its disposal by Lloyds TSB Group in February 2000. As a result of this review, the Group is required to pay compensation to customers in those cases where sales practices are found to have been deficient. A provision has been established to meet the cost of the payments to those customers; a provision is also held against the estimated cost of redress payments to customers in respect of products sold by the Abbey Life sales force prior to 1988. During 2004 management has reviewed the adequacy of the provisions held in the light of experience and changing market conditions and an additional charge of £12 million (2003: £56 million; 2002: £165 million) has been made.

	2004 **£m**	2003 £m	2002 £m
Movements in the provision over the last three years:			
At 1 January	**149**	165	–
Accrual of interest on the provision	**3**	5	–
Charge for the year	**12**	56	165
Compensation paid	**(140)**	(77)	–
At 31 December	**24**	149	165

Details of the provisions held in respect of the estimated cost of making redress payments to customers in respect of past product sales by the Group's banking operations are given in note 37.

d With-profits options and guarantees

In common with other organisations in the life assurance industry, prior to its demutualisation Scottish Widows wrote policies which contained potentially valuable options and guarantees, including guaranteed annuity option policies. Under the terms of the transfer of the Scottish Widows business, a separate memorandum account was created within the With-Profits Fund called the Additional Account which is available, inter alia, to meet any additional costs of providing guaranteed benefits on transferred policies; the Additional Account had a value at 31 December 2004 of £1.4 billion (2003: £1.4 billion). To the extent that the Additional Account is insufficient to provide these benefits any shortfall would be met by Lloyds TSB Group.

Since demutualisation in 2000, Scottish Widows continued to write policies containing similar features, although the volume of products written has since reduced and is now not significant. The Additional Account is not available to meet any additional cost of providing the benefits on these policies.

The eventual cost of providing benefits on the policies written both pre and post demutualisation is dependent upon a large number of variables, including in particular:

- future interest rate and equity market trends;
- demographic factors, such as future persistency and mortality; and
- the proportion of policyholders who seek to exercise their options.

The ultimate cost, and any impact upon Lloyds TSB Group, will not be known for many years. However, Scottish Widows has developed, and will continue to develop, an actuarial model to assist in the management of the With-Profits Fund and to meet regulatory requirements. The model allows management to estimate the effects of different economic scenarios upon the financial position of the fund and consider the implications of different management actions. Output from this model indicates that the possible cost of providing benefits on policies containing features such as options and guarantees varies widely and, depending on the economic scenario encountered, could result in Lloyds TSB Group incurring a liability. Based on the information available at present, having considered the range of possible outcomes, and after making allowance for the effect of proposed future management actions, Lloyds TSB Group currently considers that no provision is necessary. However, the model is subject to ongoing development and the position will be kept under review.

e Assumptions

In accordance with the Association of British Insurers' detailed guidance for the preparation of figures using the achieved profits method of accounting, the Group has reviewed the economic assumptions used in the embedded value calculations. The guidance requires that the assumptions should be reviewed at each reporting date.

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

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

29 Long-term assurance business (continued)

The revised assumptions have resulted in a net charge to the profit and loss account of £2 million.

Other assumptions used to derive the embedded value are as follows:

- Assumed rates of mortality and morbidity are taken from published tables adjusted for demographic differences. Assumptions in respect of lapse rates take into account both the effects of recent actual experience and future expectations of the companies concerned.
- Current tax legislation and rates have been assumed to continue unaltered, except where future changes have been announced. The UK corporation tax rate used for grossing up was 30 per cent (2003: 30 per cent). The normalised investment earnings have been grossed up at a composite longer term tax rate of 18 per cent (2003: 17 per cent).
- The value of the in-force business does not allow for future premiums under recurring single premium business or non-contractual increments, which are included in new business when the premium is received. Department of Social Security rebates have been treated as recurring single premiums.
- Future bonus rates on with-profits business are set at levels which would fully utilise the assets supporting the with-profits business. The proportion of profits derived from with-profits business allocated to the shareholder has been assumed to continue at the current rate of one-ninth of the cost of the eligible bonus, in accordance with the terms of the transfer of the Scottish Widows business.

f Sensitivities

The table below shows the effect on both the embedded value at 31 December 2004 and the new business contribution for the year then ended of theoretical changes in the main economic assumptions.

	Embedded value £m	Newbusiness contribution £m
As published	**6,781**	**225**
Effect of a 1% increase in the discount rate	**(189)**	**(26)**
Effect of a 1% reduction in the discount rate	**213**	**30**
Effect of a 1% reduction in the return on equities	**(84)**	**(12)**

g Balance sheet

The long-term assurance assets attributable to policyholders comprise:

	2004 £m	2003 £m
Investments	**56,960**	52,082
Premises and equipment	**35**	40
Other assets	**1,741**	1,680
	58,736	53,802
Net tangible assets of life companies including surplus	**(3,842)**	(3,602)
	54,894	50,200
Investments shown above comprise:		
Fixed interest securities	**15,985**	15,947
Stocks, shares and unit trusts	**31,896**	27,590
Investment properties	**3,150**	3,540
Other properties	**120**	121
Mortgages and loans	**76**	65
Deposits	**5,733**	4,819
	56,960	52,082
The liabilities to policyholders comprise:		
Technical provisions:		
– Long-term business provision (net of reinsurance)	**23,705**	23,730
– Claims outstanding (net of reinsurance)	**246**	238
Technical provisions for linked liabilities	**28,256**	25,023
Fund for future appropriations	**1,379**	346
Other liabilities	**1,308**	863
	54,894	50,200

For the purposes of consolidating the long-term assurance policyholder assets and liabilities into the Group’s balance sheet a deduction has been made of £130 million (2003: £122 million) for own shares held within the with-profit funds.

29 Long-term assurance business (continued)

h Disclosures on a modified statutory solvency basis

The individual statutory accounts of the Group's life assurance subsidiaries are prepared under the modified statutory solvency basis, in the same way as the statutory accounts of listed insurance groups in the UK. The principal difference between the modified statutory solvency basis and the embedded value basis used for the preparation of the Group's accounts is that accounts prepared under the modified statutory solvency basis do not reflect the value of in-force business.

Under the modified statutory solvency basis, the results of the Group's long-term life and pensions businesses were as follows:

	2004 £m	2003 £m	2002 £m
Premiums	**5,575**	5,139	5,524
Investment income	**1,981**	2,073	1,942
Unrealised gains on investments	**2,815**	4,833	–
Other income	**–**	6	33
	10,371	12,051	7,499
Claims	**(5,222)**	(4,433)	(5,031)
Change in technical provisions	**(3,208)**	(4,540)	3,877
Expenses	**(535)**	(689)	(720)
Realised gains (losses) on investments	**244**	(1,679)	(1,790)
Unrealised losses on investments	**–**	(22)	(4,353)
Other charges	**–**	(4)	(3)
Tax attributable to long-term business	**(110)**	(41)	200
Transfer to the fund for future appropriations	**(1,084)**	(414)	(84)
Balance on the technical account – long-term business	**456**	229	(405)
Tax attributable to balance on the technical account – long-term business	**155**	112	(190)
Income in shareholder fund	**55**	34	35
Expenses in shareholder fund	**–**	–	(1)
Profit (loss) on ordinary activities before tax	**666**	375	(561)
Tax on profit on ordinary activities	**(170)**	(125)	177
Profit (loss) on ordinary activities after tax	**496**	250	(384)
Dividends proposed	**(200)**	–	–
Profit (loss) for the financial year	**296**	250	(384)

Income from long-term assurance business after tax reconciles to the profit (loss) calculated on a modified statutory solvency basis as follows:

	2004 £m	2003 £m	2002 £m
Income from long-term assurance business attributable to the shareholder after tax	**516**	296	(250)
Increase in value-in-force taken to profit	**(60)**	(2)	(166)
	456	294	(416)
Other differences:			
Movement in deferred acquisition costs	**89**	66	45
Tax adjustment	**7**	(60)	55
Other	**(56)**	(50)	(68)
Profit (loss) on ordinary activities after tax on a modified statutory solvency basis	**496**	250	(384)

29 Long-term assurance business (continued)

A summarised balance sheet on a modified statutory solvency basis was as follows:

	2004 £m	2003 £m
Assets		
Investments	**29,069**	27,468
Assets held to cover linked liabilities	**28,256**	25,023
Other assets	**1,992**	2,018
Total assets	**59,317**	54,509
Liabilities		
Shareholder's funds	**4,581**	4,234
Fund for future appropriations	**1,379**	346
Long-term business provision†	**23,705**	23,730
Technical provision for linked liabilities†	**28,256**	25,023
Other creditors	**1,396**	1,176
Total liabilities	**59,317**	54,509

† Net of reinsurers' share of technical provisions

The value of long-term business attributable to the shareholder on an embedded value basis reconciles to the net assets of the Group's life and pensions subsidiaries calculated on a modified statutory solvency basis as follows:

	2004 £m	2003 £m
Long-term assurance business attributable to the shareholder – embedded value basis	**6,781**	6,481
Value of in-force business	**(2,939)**	(2,879)
	3,842	3,602
Other differences:		
Deferred acquisition costs	**585**	496
Tax adjustment	**152**	145
Other adjustments	**2**	(9)
Net tangible assets of life operations on a modified statutory solvency basis	**4,581**	4,234

30 Assets and liabilities denominated in foreign currencies

	2004 £m	2003 £m
Assets		
Denominated in sterling	**171,704**	153,775
Denominated in other currencies	**53,375**	48,159
	225,079	201,934
Liabilities		
Denominated in sterling	**171,587**	153,769
Denominated in other currencies	**53,492**	48,165
	225,079	201,934

Assets and liabilities exclude long-term assurance assets attributable to policyholders and liabilities to policyholders.

31 Deposits by banks

	2004 £m	2003 £m
Repayable on demand	**5,183**	7,455
Other deposits by banks with agreed maturity dates or periods of notice by residual maturity repayable:		
3 months or less	**31,833**	15,002
1 year or less but over 3 months	**2,500**	1,197
5 years or less but over 1 year	**21**	69
Over 5 years	**201**	232
	39,738	23,955

The breakdown of deposits by banks between the domestic and international offices of the Group is set out below:

	2004 £m	2003 £m
Domestic:		
Non-interest bearing	**180**	144
Interest bearing	**33,029**	18,715
	33,209	18,859
International:		
Non-interest bearing	**32**	61
Interest bearing	**6,497**	5,035
	6,529	5,096
	39,738	23,955

32 Customer accounts

	2004 £m	2003 £m
Repayable on demand	**93,846**	90,539
Other customer accounts with agreed maturity dates or periods of notice by residual maturity repayable:		
3 months or less	**18,938**	17,316
1 year or less but over 3 months	**2,442**	1,846
5 years or less but over 1 year	**5,632**	5,431
Over 5 years	**1,204**	1,364
	122,062	116,496

The breakdown of customer accounts between the domestic and international offices of the Group is set out below:

	2004 £m	2003 £m
Domestic:		
Non-interest bearing	**3,529**	3,328
Interest bearing	**115,699**	109,384
	119,228	112,712
International:		
Non-interest bearing	**296**	358
Interest bearing	**2,538**	3,426
	2,834	3,784
	122,062	116,496

33 Debt securities in issue

	2004 £m	2003 £m
Bonds and medium-term notes by residual maturity repayable:		
1 year or less	**167**	711
2 years or less but over 1 year	**144**	81
5 years or less but over 2 years	**1,053**	1,099
Over 5 years	**3,999**	3,623
	5,363	5,514
Other debt securities by residual maturity repayable:		
3 months or less	**18,489**	17,942
1 year or less but over 3 months	**2,941**	2,015
5 years or less but over 1 year	**424**	283
Over 5 years	**–**	168
	21,854	20,408
	27,217	25,922

Debt securities in issue include certificates of deposit of £15,226 million (2003: £16,415 million) and commercial paper of £6,473 million (2003: £3,625 million). An amount of £5,097 million (2003: £5,184 million) relating to debt securities issued under the Group's Euro Medium Term Note programme is included in these figures.

34 Other liabilities

	2004 £m	2003 £m
Balances arising from derivatives used for trading purposes (note 47a)	**3,135**	3,499
Balances arising from derivatives used for hedging purposes	**667**	503
Current tax	**399**	503
Dividends	**1,315**	1,314
Settlement balances	**38**	40
Other liabilities	**1,065**	1,148
	6,619	7,007

35 Accruals and deferred income

	2004 £m	2003 £m
Interest payable	**1,581**	1,216
Other creditors and accruals	**2,285**	1,990
	3,866	3,206

36 Deferred tax

	2004 £m	2003 £m
Short-term timing differences	**(196)**	(229)
Accelerated depreciation allowances	**1,669**	1,605
	1,473	1,376

	£m
At 1 January 2004	**1,376**
Exchange and other adjustments	**(26)**
Adjustments on disposal of assets	**(23)**
Charge for the year	**146**
At 31 December 2004	**1,473**

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in the future has been entered into. Deferred tax balances have not been discounted.

36 Deferred tax (continued)

The deferred tax balance at 31 December 2004 does not include any amounts in respect of the Group’s post-retirement benefit liability which is shown on the balance sheet after deduction of a deferred tax asset of £956 million (2003: £916 million) (note 45).

37 Other provisions for liabilities and charges

	Customer remediation provisions £m	Insurance provisions £m	Vacant leasehold property and other £m	Total £m
At 1 January 2004	**97**	**219**	**86**	**402**
Exchange and other adjustments	**–**	**(6)**	**–**	**(6)**
Adjustments on disposal of businesses	**–**	**–**	**(1)**	**(1)**
Provisions applied	**(105)**	**(203)**	**(13)**	**(321)**
Charge for the year	**100**	**224**	**19**	**343**
At 31 December 2004	**92**	**234**	**91**	**417**

Customer remediation provisions

The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, where the original sales processes are found to have been deficient. During 2004 management have again reviewed the adequacy of the provisions held having regard to current complaint volumes and the level of payments being made and as a result an additional charge of £100 million (2003: £200 million) has been made.

At 31 December 2004 the provisions held mainly related to past sales of mortgage endowment policies. Mortgage endowments were sold to customers through the branch network of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester, and underwritten by life assurance companies within the Group and also by third parties. The principal assumptions that have been made in the calculation of the provision relate to the number of cases that are likely to require redress and the estimated average cost per case. The ultimate cost and timing of the payments remains highly uncertain and will be influenced by external factors beyond the control of management, such as regulatory actions, media interest and the performance of the financial markets. However, it is expected that the majority of the expenditure will be incurred over the next two years.

Insurance provisions

The Group’s general insurance subsidiary maintains provisions for outstanding claims which represent the ultimate cost of settling all claims arising from events which have occurred up to the balance sheet date and these include provisions for the cost of claims notified but not settled and for claims incurred but not yet reported. In addition, in line with the requirements of the Insurance Companies (Reserves) Act 1995, a claims equalisation provision is maintained in relation to property business. The majority of provisions in respect of claims will be settled in the following year, although new provisions will then be required in respect of claims arising from that year. The level of the claims equalisation provision will be adjusted annually, taking into account the guidelines contained in the legislation, and such provisions will be held for as long as the Group continues to write the relevant types of general insurance business.

The Group also carries provisions in respect of its obligations relating to UIC Insurance Company Limited (‘UIC’), which is partly owned by the Group. The Group has indemnified a third party against losses in the event that UIC does not honour its obligations under a re-insurance contract, which is subject to asbestosis and pollution claims in the US. The ultimate exposure to claims in respect of the insurance business of UIC is uncertain. Accordingly, the provision has been based upon an actuarial estimate of prospective claims, taking account of re-insurance arrangements protecting UIC and UIC’s available assets. Given the long-term nature of many of the claims to which UIC is exposed, it is expected to be many years before the Group’s ultimate liability can be assessed with certainty.

Vacant leasehold property and other

Vacant leasehold property provisions are made by reference to a prudent estimate of expected sub-let income and the possibility of disposing of the Group’s interest in the lease, taking into account conditions in the property market. These provisions are reassessed on an annual basis and will run off during the remaining life of the leases concerned; the run off period currently averages 5 years. Where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

38 Subordinated liabilities

	Notes	2004 £m	2003 £m
Undated loan capital		**5,852**	5,959
Dated loan capital		**4,400**	4,495
Total subordinated liabilities		**10,252**	10,454

	Notes	2004 £m	2003 £m
Undated loan capital*†			
Primary Capital Undated Floating Rate Notes:	a		
Series 1 (US$750 million)		**389**	419
Series 2 (US$500 million)		**259**	279
Series 3 (US$600 million)		**311**	335
$11\frac{3}{4}$% Perpetual Subordinated Bonds		**100**	100
6.625% Perpetual Capital Securities (€750 million)	b	**526**	523
6.90% Perpetual Capital Securities			
callable 2007 (US$1,000 million)	c	**512**	550
$5\frac{5}{8}$% Undated Subordinated Step-up Notes			
callable 2009 (€1,250 million)	f	**877**	874
Undated Step-up Floating Rate Notes			
callable 2009 (€150 million)	a	**105**	105
$6\frac{5}{8}$% Undated Subordinated Step-up Notes callable 2010	e	**407**	407
6.35% Step-up Perpetual Capital Securities			
callable 2013 (€500 million)	d, f	**350**	349
5.57% Undated Subordinated Step-up			
Coupon Notes callable 2015 (¥20,000 million)	g	**101**	104
5.125% Undated Subordinated Step-up Notes			
callable 2016		**497**	496
$6\frac{1}{2}$% Undated Subordinated Step-up Notes callable 2019	e	**267**	267
8% Undated Subordinated Step-up Notes callable 2023	e	**199**	199
$6\frac{1}{2}$% Undated Subordinated Step-up Notes callable 2029	e	**455**	455
6% Undated Subordinated Step-up			
Guaranteed Bonds callable 2032	e	**497**	497
		5,852	5,959
Dated loan capital			
Subordinated Floating Rate Notes 2004		**–**	5
$7\frac{3}{8}$% Subordinated Bonds 2004		**–**	400
Subordinated Floating Rate Notes 2004		**–**	100
$8\frac{1}{2}$% Subordinated Bonds 2006		**250**	249
$7\frac{3}{4}$% Subordinated Bonds 2007		**299**	299
$5\frac{1}{4}$% Subordinated Notes 2008 (DM 750 million)		**270**	269
$10\frac{5}{8}$% Guaranteed Subordinated Loan Stock 2008		**100**	100
$9\frac{1}{2}$% Subordinated Bonds 2009		**100**	100
Subordinated Step-up Floating Rate Notes 2009			
callable 2004 (US$500 million)		**–**	279
$6\frac{1}{4}$% Subordinated Notes 2010 (€400 million)		**281**	281
Subordinated Floating Rate Notes 2010 (US$400 million)	a	**207**	223
12% Guaranteed Subordinated Bonds 2011		**100**	100
$9\frac{1}{8}$% Subordinated Bonds 2011		**149**	149
$4\frac{3}{4}$% Subordinated Notes 2011 (€850 million)		**582**	578
$5\frac{7}{8}$% Subordinated Guaranteed Bonds 2014 (€750 million)		**462**	461
$5\frac{7}{8}$% Subordinated Notes 2014		**148**	148
$6\frac{7}{8}$% Subordinated Notes 2015		**345**	345
Subordinated Step-up Floating Rate Notes 2016			
callable 2011 (€500 million)	a, h	**353**	–
Subordinated Floating Rate Notes 2020 (€100 million)	a	**70**	70
$9\frac{5}{8}$% Subordinated Bonds 2023		**338**	339
5.75% Subordinated Step up Notes 2025 callable 2020	h	**346**	–
		4,400	4,495

38 Subordinated liabilities (continued)

These liabilities will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer.

* In certain circumstances, these notes and bonds would acquire the characteristics of preference share capital.

† Any repayments of undated loan capital would require the prior consent of the Financial Services Authority.

a) These notes bear interest at rates fixed periodically in advance based on London Interbank rates.

b) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds TSB Group plc can declare or pay a dividend until any deferred payments have been made. In the event of a winding up of Lloyds TSB Bank plc, these securities will acquire the characteristics of preference shares. The securities can be redeemed at par at the option of Lloyds TSB Bank plc on or after 25 October 2006.

c) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds TSB Group plc can declare or pay a dividend until payments are resumed. Any deferred payments will be made good on redemption of the securities. In the event of a winding up of Lloyds TSB Bank plc, these securities will acquire the characteristics of preference shares. The securities can be redeemed at par at the option of Lloyds TSB Bank plc on or after 22 November 2007.

d) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds TSB Group plc can declare or pay a dividend until any deferred payments have been made. In the event of a winding up of Lloyds TSB Bank plc, these securities will acquire the characteristics of preference shares. The securities can be redeemed at par at the option of Lloyds TSB Bank plc on or after 25 February 2013.

e) At the callable date the coupon on these Notes will be reset by reference to the applicable five year benchmark gilt rate.

f) In the event that these Notes are not redeemed at the callable date, the coupon will be reset to a floating rate.

g) In the event that these Notes are not redeemed at the callable date, the coupon will be reset to a fixed margin over the then 5 year Yen swap rate.

h) Issued during 2004 primarily to finance the general business of the Group.

	2004 **£m**	2003 £m
Dated subordinated liabilities are repayable as follows:		
1 year or less	**–**	505
2 years or less but over 1 year	**250**	–
5 years or less but over 2 years	**769**	917
Over 5 years	**3,381**	3,073
	4,400	4,495

39 Non-equity minority interests

Non-equity minority interests comprise:

	2004 **£m**	2003 £m
Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)*	**302**	301
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015**	**248**	248
Capital instruments	**550**	549
European Financial Institution Investments Partnership†	**–**	100
LM ABS Investment Partnership‡	**–**	34
	550	683

* These securities constitute limited partnership interests in Lloyds TSB Capital 1 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.375 per cent per annum up to 7 February 2012; thereafter they will accrue at a rate of 233 basis points above EURIBOR, to be set annually.

** These securities constitute limited partnership interests in Lloyds TSB Capital 2 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.834 per cent per annum up to 7 February 2015; thereafter they will accrue at a rate of 350 basis points above a rate based on the yield of specified UK government stock.

Both of the above issues were made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc. Lloyds TSB Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.

39 Non-equity minority interests (continued)

† These securities constituted interests in European Financial Institution Investments Partnership, an English law general partnership in which the principal partner is Langbourn Holdings Limited, a wholly owned subsidiary of the Group. During 2004 the partnership was dissolved and the capital returned to the partners.

‡ These securities constituted interests in LM ABS Investment Partnership, an English law general partnership in which the principal partner was Lime Street (Funding) Limited, a wholly owned subsidiary of the Group. During 2004 the partnership was dissolved and the capital returned to the partners.

40 Called-up share capital

	2004	2003	2002
Authorised:			
Sterling	**£m**	£m	£m
6,911 million Ordinary shares of 25p each	**1,728**	1,728	1,728
79 million Limited voting ordinary shares of 25p each	**20**	20	20
175 million Preference shares of 25p each	**44**	44	44
	1,792	1,792	1,792
US dollars	**US$m**	US$m	US$m
160 million Preference shares of US25 cents each	**40**	40	40
Euro	**€m**	€m	€m
160 million Preference shares of €25 cents each	**40**	40	40
Japanese yen	**¥m**	¥m	¥m
50 million Preference shares of ¥25 each	**1,250**	1,250	1,250

	2004 £m	2003 £m	2002 £m
Issued and fully paid:			
Ordinary shares of 25p each			
At 1 January	**1,398**	1,396	1,391
Issued to the QUEST (note 43) (2004: nil; 2003: 6 million shares; 2002: 18 million shares)	**–**	1	5
Issued under employee share schemes (2004: 3 million shares; 2003: 5 million shares; 2002: 1 million shares)	**1**	1	–
At 31 December	**1,399**	1,398	1,396
Limited voting ordinary shares of 25p each			
At 1 January and 31 December	**20**	20	20
	1,419	1,418	1,416

In addition, during the year the directors approved the allotment at par of 400 6 per cent non-cumulative redeemable preference shares of 25p each. The shares, which are redeemable at the option of the Company at any time, carry the rights to a fixed rate non-cumulative preferential dividend at a rate of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Company.

Number of shares in issue:	**2004**	2003	2002
Ordinary shares of 25p each	**5,596,397,111**	5,593,737,422	5,583,099,804
Limited voting ordinary shares of 25p each	**78,947,368**	78,947,368	78,947,368
6% Non-Cumulative Redeemable Preference shares of 25p each	**400**	–	–

The limited voting ordinary shares are held by the Lloyds TSB Foundations. These shares carry no rights to dividends but rank pari passu with the ordinary shares in respect of other distributions and in the event of winding up. These shares do not have any right to vote at general meetings other than on resolutions concerning acquisitions or disposals of such importance that they require shareholder consent, or for the winding up of the Company, or for a variation in the class rights of the limited voting ordinary shares.

Lloyds TSB Group plc has entered into deeds of covenant with the Lloyds TSB Foundations, under the terms of which the Company makes annual donations to the foundations equal, in total, to 1 per cent of the Group’s pre-tax profits (after certain adjustments) averaged over three years. The deeds of covenant can be cancelled by the Company at nine years’ notice.

40 Called-up share capital (continued)

At 31 December 2004, options to acquire 162 million Lloyds TSB Group ordinary shares of 25p each were outstanding under the executive share option schemes, the share retention plan and the staff sharesave share option schemes exercisable up to 2014. These include the option, described on page 89, to acquire 216,763 shares under the share retention plan: otherwise the options are exercisable at prices ranging from 243p to 888p per share.

41 Reserves

	2004 £m	2003 £m	2002 £m
Share premium account:			
At 1 January	**1,136**	1,093	959
Premium arising on issue of shares	**9**	43	134
At 31 December	**1,145**	1,136	1,093
Merger reserve:			
At 1 January and 31 December	**343**	343	343
Profit and loss account:			
At 1 January	**6,727**	5,091	7,613
Exchange and other adjustments	**(11)**	118	(3)
Actuarial losses recognised in post-retirement benefit schemes (note 45)	**(166)**	(4)	(2,331)
Movements in relation to own shares (note 43)	**10**	(2)	(70)
Goodwill written back on sale of businesses	**3**	181	–
Profit (loss) for the year	**507**	1,343	(118)
At 31 December	**7,070**	6,727	5,091

The profit and loss account reserves at 31 December 2004 include approximately £1 billion (2003: £1 billion; 2002: £1 billion) not presently available for distribution representing the Group’s share of the value of long-term assurance business in force and the surplus retained within the long-term assurance funds. The profit and loss account reserves at 31 December 2004 are stated after including a deficit of £2,231 million relating to the Group’s post-retirement defined benefit schemes (2003: £2,139 million; 2002: £2,077 million) and after deducting £31 million (2003: £39 million; 2002: £43 million) in respect of own shares held.

The cumulative amount of premiums on acquisitions written off against reserves during previous years amounts to £2,087 million (2003: £2,090 million; 2002: £2,271 million) of which £1,682 million (2003: £1,662 million; 2002: £1,823 million) was within the last 10 years.

The accumulated foreign exchange adjustment at 31 December 2004 reduced reserves by £155 million (2003: £144 million; 2002: £262 million).

42 Shareholders’ funds

	2004 £m	2003 £m	2002 £m
Equity	**9,977**	9,624	7,943
Non-equity	**–**	–	–
	9,977	9,624	7,943

Non-equity shareholders’ funds comprise 400 non-cumulative redeemable preference shares of 25p each which were issued during 2004 at par.

43 Own shares

The amounts deducted from profit and loss account reserves in respect of own shares, which are held at cost, are comprised as follows:

	2004 £m	2003 £m	2002 £m
Own shares held in relation to employee shares schemes*	**14**	22	26
Lloyds TSB Group interest in shares held by the long-term assurance funds†	**17**	17	17
Own shares	**31**	39	43

* Lloyds TSB Group plc sponsors the Lloyds TSB Group Employee Share Ownership Trust, a discretionary trust for the benefit of employees and former employees of Lloyds TSB Group. The Company has lent £20.6 million to the trustees, interest free, to enable them to purchase Lloyds TSB Group plc ordinary shares, which are used to satisfy options granted by the Company or to meet commitments arising under other employee share schemes. Under the terms of the trust, the trustees have waived all but a nominal dividend on the shares they hold. At 31 December 2004, 1.5 million shares were held by the trustees with a cost of £11.5 million (2003: 1.6 million shares with a cost of £12.6 million; 2002: 2 million shares with a cost of £13 million).

Lloyds TSB Group has also established the Lloyds TSB Qualifying Employee Share Ownership Trust ('the QUEST') for the purpose of providing shares on the exercise of options under certain of the Group's Save As You Earn (SAYE) share option schemes. During 2004 Lloyds TSB Group plc made no contributions to the QUEST (2003: nil; 2002: £66 million); the trustees did not subscribe for any shares in the Company in 2004 (2003: 6 million shares for a consideration of £26 million; 2002: 18 million shares for a consideration of £136 million). At 31 December 2004, 1,364 shares were held by the QUEST (2003: 0.2 million shares with a cost of £0.7 million; 2002: 1.7 million shares with a cost of £13 million). Under the terms of the QUEST's trust deed, the trustees have waived all but a nominal dividend on the shares they hold.

The Lloyds TSB Group Shareplan ('Shareplan') has been established for the purpose of providing an enhanced remuneration package for employees. The shares are used to provide shares awarded to employees for no consideration, as a percentage of salaries by reference to the profits of Lloyds TSB Group, together with partnership shares which are acquired by employees via monthly contributions; and matching shares, which are additional shares awarded for no consideration to employees acquiring partnership shares. At 31 December 2004, 0.5 million shares (2003: 2.2 million shares) were held but not allocated to individual employees by the Shareplan trustees with a cost to the Group of £2.3 million (2003: £9.2 million). The trustees have waived all dividends on the shares they hold.

In addition, a further 0.2 million ordinary shares were held by Lloyds TSB Group Holdings (Jersey) Limited at 31 December 2004 (2003: 0.4 million shares; 2002: 0.4 million shares). These shares, on which the dividend entitlement has been waived, were gifted to Lloyds TSB Group some years ago at nil cost and are used to satisfy outstanding options or to meet commitments arising under other employee share schemes.

† The long-term assurance funds of Scottish Widows hold 30.5 million shares (2003: 30.5 million shares; 2002: 30.5 million shares) in Lloyds TSB Group plc which were bought prior to the acquisition of Scottish Widows by Lloyds TSB Group. Due to the structure of these funds, Lloyds TSB Group is effectively exposed to the risks and rewards of ownership of one tenth of these shares; the risks and rewards of ownership of the remaining nine tenths are borne by the policyholders.

Movements in the amount deducted from reserves in respect of own shares have been as follows:

	2004 £m	2003 £m	2002 £m
At 1 January	**39**	43	50
Purchases of, and subscriptions for, shares	**57**	74	185
Use of shares on exercise of employee options and for other employee share plans	**(67)**	(78)	(192)
Shares forfeited in the year	**2**	–	–
At 31 December	**31**	39	43

The credit of £10 million to profit and loss account reserves represents the net reduction in the cost of own shares of £8 million and an increase in the accrual in respect of the free shares to be awarded in respect of Shareplan of £2 million. (The charge of £2 million in 2003 represented the loss on transactions in own shares of £10 million less the net reduction in the cost of own shares of £4 million and an increase in the accrual in respect of the free shares to be awarded in respect of Shareplan of £4 million. The charge of £70 million in 2002 represented the loss on transactions in own shares of £65 million and a decrease in the accrual in respect of the free shares to be awarded in respect of Shareplan of £12 million less the net reduction in the cost of own shares of £7 million).

44 Related party transactions

a Transactions, arrangements and agreements involving directors and others

At 31 December 2004, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons and with officers included:

	2004 Number of persons	**2004 Total £000**	2003 Number of persons	2003 Total £000
Loans and credit card transactions:				
Directors and connected persons	**4**	**3,217**	6	3,199
Officers	**22**	**6,747**	30	5,355

During 2003 one officer purchased a car from the Group for a total consideration of £27,000.

b Group undertakings

Details of the principal group undertakings are given in note 21. In accordance with FRS 8, transactions or balances with group entities that have been eliminated on consolidation are not reported.

c Joint ventures

Details of the Group's joint ventures are provided in note 20. Information relating to transactions entered into between Group undertakings and the joint ventures and details of outstanding balances at 31 December 2004 are also shown in note 20.

d Long-term assurance business

The Group enters into transactions with its long-term assurance businesses, which cannot be eliminated in the consolidated accounts because of the basis of accounting used for the Group's long-term assurance businesses. After taking into account legally enforceable netting agreements, at 31 December 2004 Group entities owed £2,254 million (2003: £1,995 million) and were owed £97 million (2003: £136 million); these amounts are included in customer accounts and loans and advances to customers respectively. Furthermore Scottish Widows plc has provided £50 million (2003: £30 million) of subordinated loan capital to Scottish Widows Bank plc, which is included in other liabilities. In addition, fees of £201 million (2003: £107 million; 2002: £76 million) were received, and fees of £49 million (2003: £71 million; 2002: £35 million) were paid, in respect of distribution, asset management and other services.

Certain administrative properties used by Scottish Widows are owned by the long-term assurance funds. During 2004 Scottish Widows paid rent to the long-term assurance funds amounting to £5 million (2003: £5 million; 2002: £5 million)). In addition, at 31 December 2004, the long-term assurance funds owned 30.5 million ordinary shares in the Company (2003: 30.5 million shares).

e Pension funds

Group entities provide a number of banking and other services to the Group's pension funds, which are conducted on similar terms to third party transactions. At 31 December 2004, the Group's pension funds had call deposits with Lloyds TSB Bank plc amounting to £14 million (2003: £16 million).

45 Pensions and other post-retirement benefits

The pension costs included in administrative expenses are comprised as follows:

	2004 £m	2003 £m	2002 £m
Defined contribution schemes	**32**	33	25
Defined benefit schemes	**306**	320	293
	338	353	318

The majority of the Group's employees are members of the defined benefit sections of Lloyds TSB Group Pension Schemes No's 1 and 2. During the year ended 31 December 2002, the Group made no contributions to either of these schemes. During 2003 and 2004, no contributions have been made to the Lloyds TSB Group Pension Scheme No. 2. However, with effect from 1 July 2003 the Group recommenced contributions to the Lloyds TSB Group Pension Scheme No. 1 at a rate of 31.7 per cent of pensionable salary; this was increased to 56.5 per cent of pensionable salary with effect from 1 January 2004. Since the defined benefit sections of these schemes are now closed to new members and the age profile of the active members is increasing, under the projected unit method, the current service cost will increase as the members of the schemes approach retirement.

The latest full valuations of these schemes were carried out as at 30 June 2002; these have been updated to 31 December 2004 by qualified independent actuaries. The last full valuations of other group schemes were carried out on a number of different dates; these have been updated to 31 December 2004 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows.

45 Pensions and other post-retirement benefits (continued)

The principal assumptions used in the scheme valuations were as follows:

	31 December 2004 %	31 December 2003 %	31 December 2002 %
Rate of inflation	**2.60**	2.50	2.30
Rate of salary increases	**4.14**	4.04	3.83
Rate of increase for pensions in payment and deferred pensions	**2.60**	2.50	2.30
Discount rate	**5.30**	5.40	5.60

In addition, the Group operates a number of schemes which provide post-retirement healthcare benefits to certain employees, retired employees and their dependent relatives. The principal scheme relates to former Lloyds Bank staff and under this scheme the Group has undertaken to meet the cost of post-retirement healthcare for all eligible former employees (and their dependents) who retired prior to 1 January 1996. For retirements subsequent to this date, the Group also met a reducing proportion of the cost until 31 December 2004, since which date the only obligation is in respect of the pre 1 January 1996 retirements.

Included within other finance income is an interest cost of £4 million (2003: £5 million; 2002: £4 million) in respect of these defined benefit post-retirement healthcare schemes.

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 31 December 2000; this valuation has been updated to 31 December 2004 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 6.7 per cent.

The assets of the Group's defined benefit schemes and the expected rates of return are summarised as follows:

	Fair value at 31 December 2004 £m	**Expected long-term rate of return at 31 December 2004 %**	Fair value at 31 December 2003 £m	Expected long-term rate of return at 31 December 2003 %	Fair value at 31 December 2002 £m	Expected long-term rate of return at 31 December 2002 %
Market values of scheme assets:						
Equities	**8,042**	**8.2**	7,454	8.1	7,175	8.4
UK fixed interest gilts	**550**	**4.6**	551	4.8	557	4.5
UK index linked gilts	**561**	**4.3**	545	4.4	–	–
Sterling non-government bonds	**941**	**5.3**	1,033	5.4	491	5.6
Property	**959**	**6.9**	713	7.1	791	6.9
Cash	**611**	**3.6**	307	3.5	69	3.8
Total fair value of scheme assets	**11,664**		10,603		9,083	

Other finance income comprises:

	2004 £m	2003 £m	2002 £m
Expected return on scheme assets	**764**	696	817
Interest cost of scheme liabilities	**(725)**	(662)	(652)
	39	34	165

The pension and other post-retirement benefit cost in respect of defined benefit schemes comprises:

	2004 £m	2003 £m	2002 £m
Current service cost	**289**	269	244
Past service costs	**17**	51	49
Defined benefit costs	**306**	320	293

45 Pensions and other post-retirement benefits (continued)

The amounts recognised in the statement of total recognised gains and losses comprise:

	2004 **£m**	2003 £m	2002 £m
Actual return less expected return on scheme assets	**369**	802	(2,582)
Experience gains and losses arising on scheme liabilities	**(114)**	94	(240)
Effect of changes in demographic and financial assumptions	**(492)**	(902)	(477)
Actuarial losses recognised	**(237)**	(6)	(3,299)
Deferred tax thereon	**71**	2	968
Amount recognised in the statement of total recognised gains and losses	**(166)**	(4)	(2,331)

The experience gains and losses recognised can also be analysed as follows:

	2004 **£m**	2003 £m	2002 £m	2001 £m
Actual return less expected return on scheme assets:				
Amount	**369**	802	(2,582)	(2,015)
Percentage of scheme assets at balance sheet date	**3.2%**	7.6%	28.4%	18.1%
Experience gains and losses arising on scheme liabilities:				
Amount	**(114)**	94	(240)	(71)
Percentage of scheme liabilities at balance sheet date	**0.8%**	0.7%	2.0%	0.7%
Total amount recognised in the statement of total recognised gains and losses:				
Amount	**(237)**	(6)	(3,299)	(2,873)
Percentage of scheme liabilities at balance sheet date	**1.6%**	0.0%	27.5%	26.9%

The amounts reported on the Group's balance sheet are comprised as follows:

	2004 **£m**	2003 £m
Market value of assets	**11,664**	10,603
Present value of scheme liabilities	**(14,851)**	(13,658)
Deficit in the schemes	**(3,187)**	(3,055)
Related deferred tax asset	**956**	916
Net post-retirement benefit liability	**(2,231)**	(2,139)

The movements in the deficit in the schemes over the last two years have been as follows:

	2004 **£m**	2003 £m
Deficit at beginning of year	**(3,055)**	(2,931)
Exchange and other adjustments	**(2)**	(4)
Other finance income	**39**	34
Current service costs	**(289)**	(269)
Contributions	**374**	138
Past service costs	**(17)**	(51)
Actuarial loss	**(237)**	(6)
Adjustments on disposal of businesses	**–**	34
Deficit at end of year	**(3,187)**	(3,055)

46 Contingent liabilities and commitments

Acceptances and endorsements arise where the Lloyds TSB Group agrees to guarantee payment on a negotiable instrument drawn up by a customer.

Guarantees include those given on behalf of a customer to stand behind the current obligations of the customer and to carry out those obligations should the customer fail to do so.

Other items serving as direct credit substitutes include standby letters of credit, or other irrevocable obligations, serving as financial guarantees where the Lloyds TSB Group has an irrevocable obligation to pay a third party beneficiary if the customer fails to repay an outstanding commitment; they also include acceptances drawn under letters of credit or similar facilities where the acceptor does not have specific title to an identifiable underlying shipment of goods.

46 Contingent liabilities and commitments (continued)

Performance bonds and other transaction related contingencies (which include bid or tender bonds, advance payment guarantees, VAT Customs & Excise bonds and standby letters of credit relating to a particular contract or non-financial transaction) are undertakings where the requirement to make payment under the guarantee depends on the outcome of a future event.

Where guarantees are issued on behalf of customers, Lloyds TSB Group usually holds collateral against the exposure or has a right of recourse to the customer.

Lloyds TSB Group's maximum exposure to loss is represented by the contractual nominal amount detailed in the table below. Consideration has not been taken of any possible recoveries from customers for payments made in respect of such guarantees under recourse provisions or from collateral held or pledged.

	2004 £m	2003 £m
Contingent liabilities		
Acceptances and endorsements	**71**	299
Guarantees	**6,786**	6,122
Other:		
Other items serving as direct credit substitutes	**345**	1,069
Performance bonds and other transaction-related contingencies	**1,324**	1,534
Other contingent liabilities	**–**	1
	1,669	2,604
	8,526	9,025
Commitments		
Documentary credits and other short-term trade-related transactions	**431**	368
Forward asset purchases and forward deposits placed	**1,654**	546
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year maturity	**63,196**	62,440
1 year or over maturity	**20,009**	15,981
	85,290	79,335

47 Derivatives and other financial instruments

Information about the Group's use of financial instruments and management of the associated risks is given on pages 58 to 60.

a Derivatives

Derivatives are used to meet the financial needs of customers, as part of the Group's trading activities and to reduce its own exposure to fluctuations in interest and exchange rates. The principal derivatives used by the Group are interest rate and exchange rate contracts; particular attention is paid to the liquidity of the markets and products in which the Group trades to ensure that there are no undue concentrations of activity and risk.

Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal amount at a specific date in the future. An interest rate option gives the buyer, on payment of a premium, the right, but not the obligation, to fix the rate of interest on a future loan or deposit, for a specified period and commencing on a specified future date.

Exchange rate related contracts include forward foreign exchange contracts, currency swaps and options. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. A currency option gives the buyer, on payment of a premium, the right, but not the obligation, to sell a specified amount of currency at an agreed rate of exchange on or before a specified future date.

Equity derivatives are also used by the Group as part of its equity based retail product activity to eliminate the Group's exposure to fluctuations in various international stock exchange indices. Index-linked equity options are purchased which give the Group the right, but not the obligation, to buy or sell a specified amount of equities, or basket of equities in the form of published indices on or before a specified future date.

Derivative contracts expose the Group to both market risk and credit risk. Only a few highly specialist trading centres within the Group are permitted to enter into derivative contracts and the level of exposure to interest rate and exchange rate movements and other market variables is strictly controlled and monitored within approved limits.

47 Derivatives and other financial instruments (continued)

Unlike on-balance sheet instruments the principal amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group, should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure.

Trading

The notional principal amounts and fair values (which, after netting, are the carrying values) of trading instruments entered into with third parties were as follows:

31 December 2004	Notional principal amount £m	Fai value assets £m	Fairvalue liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	**113,601**	**1,995**	**2,632**
Currency swaps	**11,386**	**426**	**581**
Options purchased	**2,059**	**44**	**–**
Options written	**1,922**	**–**	**41**
	128,968	**2,465**	**3,254**
Interest rate contracts:			
Interest rate swaps	**275,547**	**3,118**	**3,631**
Forward rate agreements	**62,797**	**28**	**24**
Options purchased	**9,679**	**78**	**–**
Options written	**7,430**	**–**	**163**
Futures	**48,278**	**–**	**–**
	403,731	**3,224**	**3,818**
Equity and other contracts	**4,239**	**282**	**19**
Effect of netting		**(3,956)**	**(3,956)**
Balances arising from off-balance sheet financial instruments		**2,015**	**3,135**

31 December 2003	Notional principal amount £m	Fai value assets £m	Fairvalue liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	76,368	1,669	2,127
Currency swaps	10,329	328	511
Options purchased	1,678	55	14
Options written	1,542	–	39
	89,917	2,052	2,691
Interest rate contracts:			
Interest rate swaps	236,956	3,346	4,006
Forward rate agreements	54,213	29	29
Options purchased	10,475	145	–
Options written	5,265	–	162
Futures	38,626	–	–
	345,535	3,520	4,197
Equity and other contracts	5,407	693	387
Effect of netting		(3,776)	(3,776)
Balances arising from off-balance sheet financial instruments		2,489	3,499

47 Derivatives and other financial instruments (continued)

Non-trading

Through intra company and intra group transactions, Group companies establish non-trading derivatives positions with the Group's independent trading operations, which then enter into similar positions with third parties. The notional principal amounts and fair values of non-trading instruments entered into with third parties were as follows:

31 December 2004	Notional principal amount £m	Fai value assets £m	Fairvalue liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	**155**	**3**	**3**
Currency swaps	**60**	**2**	**–**
Options purchased	**1**	**–**	**–**
	216	**5**	**3**
Interest rate contracts:			
Interest rate swaps	**34,196**	**143**	**350**
Forward rate agreements	**2,921**	**6**	**–**
Options written	**111**	**–**	**–**
	37,228	**149**	**350**
Effect of netting		**(123)**	**(123)**
		31	**230**

31 December 2003	Notional principal amount £m	Fai value assets £m	Fairvalue liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	171	13	5
Currency swaps	459	28	10
	630	41	15
Interest rate contracts:			
Interest rate swaps	30,816	256	260
Forward rate agreements	7,188	1	1
Options written	40	–	–
	38,044	257	261
Effect of netting		(165)	(165)
		133	111

The aggregate carrying value of non-trading derivatives with a positive fair value was an asset of £96 million (2003: an asset of £132 million) and with a negative fair value was a liability of £35 million (2003: a liability of £71 million).

47 Derivatives and other financial instruments (continued)

The maturity of the notional principal amounts and replacement cost of both trading and non-trading instruments entered into with third parties was:

	Under 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
31 December 2004				
Exchange rate contracts				
Notional principal amount	**117,027**	**8,143**	**4,014**	**129,184**
Replacement cost	**2,015**	**179**	**276**	**2,470**
Interest rate contracts				
Notional principal amount	**224,427**	**165,274**	**51,258**	**440,959**
Replacement cost	**521**	**1,426**	**1,426**	**3,373**
Equity and other contracts				
Notional principal amount	**583**	**3,358**	**298**	**4,239**
Replacement cost	**6**	**258**	**18**	**282**
Total				
Notional principal amount	**342,037**	**176,775**	**55,570**	**574,382**
Replacement cost	**2,542**	**1,863**	**1,720**	**6,125**
31 December 2003				
Exchange rate contracts				
Notional principal amount	79,677	7,005	3,865	90,547
Replacement cost	1,753	141	199	2,093
Interest rate contracts				
Notional principal amount	175,306	161,584	46,689	383,579
Replacement cost	578	1,660	1,539	3,777
Equity and other contracts				
Notional principal amount	2,886	1,965	556	5,407
Replacement cost	523	115	55	693
Total				
Notional principal amount	257,869	170,554	51,110	479,533
Replacement cost	2,854	1,916	1,793	6,563

The notional principal amount does not represent the Group’s real exposure to credit risk, which is limited to the current cost of replacing contracts at current market rates should the counterparties default.

Net replacement cost represents the total positive fair value of all derivative contracts at the balance sheet date, after allowing for the offset of all negative fair values where the Group has a legal right of set-off with the counterparty concerned.

An analysis of the net replacement cost of both trading and non-trading instruments entered into with third parties by counterparty type is set out below; the Group’s exposure is further reduced by qualifying collateral held.

	2004 £m	2003 £m
OECD banks	**855**	1,272
Other	**1,191**	1,350
Net replacement cost	**2,046**	2,622
Qualifying collateral held	**(592)**	(416)
Potential credit risk exposure	**1,454**	2,206

47 Derivatives and other financial instruments (continued)

b Interest rate sensitivity gap analysis for the non-trading book

The table below summarises the repricing mismatches of the Group's non-trading assets and liabilities. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date. The table does not take into account the effect of interest rate options used by the Group to hedge its exposure; details of options are given in note 47a.

31 December 2004	3 months or less £m	6 months or less but over 3 months £m	1 year or less but over 6 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-interest bearing £m	Trading book £m	Total £m
Assets								
Treasury bills and other eligible bills	**43**	**40**	**–**	**5**	**–**	**–**	**4**	**92**
Loans and advances to banks	**19,663**	**1,351**	**154**	**470**	**82**	**602**	**1,243**	**23,565**
Loans and advances to customers	**99,216**	**6,443**	**6,937**	**36,783**	**6,203**	**(1,655)**	**313**	**154,240**
Debt securities and equity shares	**8,193**	**1,009**	**770**	**1,976**	**2,527**	**(68)**	**11,002**	**25,409**
Other assets	**121**	**–**	**–**	**5**	**1**	**17,375**	**4,271**	**21,773**
Total assets	**127,236**	**8,843**	**7,861**	**39,239**	**8,813**	**16,254**	**16,833**	**225,079**
Liabilities								
Deposits by banks	**36,802**	**2,009**	**289**	**122**	**81**	**212**	**223**	**39,738**
Customer accounts	**109,563**	**1,083**	**823**	**5,639**	**538**	**3,825**	**591**	**122,062**
Debt securities in issue	**18,764**	**1,848**	**1,171**	**1,435**	**3,999**	**–**	**–**	**27,217**
Other liabilities	**292**	**–**	**–**	**–**	**–**	**9,008**	**5,937**	**15,237**
Subordinated liabilities – loan capital	**1,698**	**458**	**–**	**1,884**	**6,212**	**–**	**–**	**10,252**
Minority interests and shareholders' funds	**–**	**–**	**–**	**–**	**–**	**10,550**	**23**	**10,573**
Internal funding of trading business	**(6,577)**	**635**	**129**	**(3,330)**	**(916)**	**–**	**10,059**	**–**
Total liabilities	**160,542**	**6,033**	**2,412**	**5,750**	**9,914**	**23,595**	**16,833**	**225,079**
Off-balance sheet items	**13,254**	**(3,902)**	**(2,424)**	**(9,468)**	**2,540**	**–**	**–**	**–**
Interest rate repricing gap	**(20,052)**	**(1,092)**	**3,025**	**24,021**	**1,439**	**(7,341)**	**–**	**–**
Cumulative interest rate repricing gap	**(20,052)**	**(21,144)**	**(18,119)**	**5,902**	**7,341**	**–**	**–**	**–**

31 December 2003	3 months or less £m	6 months or less but over 3 months £m	1 year or less but over 6 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-interest bearing £m	Trading book £m	Total £m
Assets								
Treasury bills and other eligible bills	408	48	65	6	3	–	9	539
Loans and advances to banks	10,686	1,311	463	746	86	366	1,889	15,547
Loans and advances to customers	88,298	4,680	5,549	30,777	6,171	(1,648)	1,424	135,251
Debt securities and equity shares	8,718	606	279	1,856	2,372	(55)	15,351	29,127
Other assets	101	–	16	8	–	16,058	5,287	21,470
Total assets	108,211	6,645	6,372	33,393	8,632	14,721	23,960	201,934
Liabilities								
Deposits by banks	22,254	635	262	286	99	205	214	23,955
Customer accounts	104,236	705	876	5,227	1,173	3,686	593	116,496
Debt securities in issue	18,375	1,507	1,040	1,210	3,790	–	–	25,922
Other liabilities	300	–	–	–	–	8,108	6,348	14,756
Subordinated liabilities – loan capital	2,088	1,086	–	910	6,370	–	–	10,454
Minority interests and shareholders' funds	–	–	–	–	–	10,333	18	10,351
Internal funding of trading business	(11,528)	(810)	(412)	(3,217)	(820)	–	16,787	–
Total liabilities	135,725	3,123	1,766	4,416	10,612	22,332	23,960	201,934
Off-balance sheet items	6,930	(1,365)	(4,049)	(2,596)	1,080	–	–	–
Interest rate repricing gap	(20,584)	2,157	557	26,381	(900)	(7,611)	–	–
Cumulative interest rate repricing gap	(20,584)	(18,427)	(17,870)	8,511	7,611	–	–	–

47 Derivatives and other financial instruments (continued)

c Fair value analysis

Financial instruments include financial assets, financial liabilities and derivatives. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Wherever possible, fair values have been estimated using market prices for instruments held by the Group. Where market prices are not available, fair values have been estimated using quoted values for instruments with characteristics either identical or similar to those of the instruments held by the Group. In certain cases, where no ready markets currently exist, various techniques (such as discounted cash flows, or observations of similar recent market transactions) have been developed to estimate what the approximate fair value of such instruments might be. These estimation techniques are necessarily subjective in nature and involve several assumptions.

The fair values presented in the following table are at a specific date and may be significantly different from the amounts which will actually be paid or received on the maturity or settlement date.

Because a variety of estimation techniques are employed and significant estimates made, comparisons of fair values between financial institutions may not be meaningful. Readers of these accounts are thus advised to use caution when using this data to evaluate the Group’s financial position.

Fair value information is not provided for items that do not meet the definitions of a financial instrument. These items include intangible assets, such as the value of the Group’s branch network, the long-term relationships with depositors and credit card relationships, premises and equipment and shareholders’ equity. These items are material and accordingly the Group believes that the fair value information presented does not represent the underlying value of the Group.

The valuation technique for each major category of financial instrument is discussed below:

Treasury bills and other eligible bills

Fair value is estimated using market prices, where available.

Loans and advances to banks and customers

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates. The carrying value of the variable rate loans and those relating to lease financing is assumed to be their fair value. For fixed rate lending, several different techniques are used to estimate fair value, as considered appropriate. For commercial and personal customers, fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Group and other financial institutions. The fair value for corporate loans was estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans has been estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period.

Debt securities and equity shares held for investment purposes

Listed investment securities are valued at quoted mid-market prices. Unlisted securities and equity shares are valued based on discounted cash flows, market prices of similar securities and other appropriate valuation techniques.

Deposits by banks and customer accounts

The fair value of deposits repayable on demand is considered to be equal to their carrying value. The fair value for all other deposits and customer accounts was estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities.

Debt securities in issue and subordinated liabilities

The fair value of short-term debt securities in issue is approximately equal to their carrying value. Fair value for other debt securities and for subordinated liabilities is estimated using quoted market prices.

Financial commitments and contingent liabilities

The Group considers that, given the lack of an established market, the diversity of fee structures and the difficulty of separating the value of the instruments from the value of the overall transaction, it is not meaningful to provide an estimate of the fair value of financial commitments and contingent liabilities. These are therefore excluded from the following table.

The table below shows a comparison by category of book values and fair values of the Group’s on-balance sheet financial assets and liabilities.

47 Derivatives and other financial instruments (continued)

31 December 2004	Tradingbook Book value £m	Tradingbook Fair value £m	Non-trading book Book value £m	Non-tradingbook Fair value £m
Assets				
Treasury bills and other eligible bills	**4**	**4**	**88**	**90**
Loans and advances to banks and customers	**1,556**	**1,556**	**176,249**	**176,712**
Debt securities and equity shares	**11,002**	**11,002**	**14,407**	**14,443**
Liabilities				
Deposits by banks and customers	**814**	**814**	**160,986**	**160,950**
Debt securities in issue	**–**	**–**	**27,217**	**26,924**
Subordinated liabilities	**–**	**–**	**10,252**	**11,544**

31 December 2003	Tradingbook Book value £m	Tradingbook Fair value £m	Non-tradingbook Book value £m	Non-tradingbook Fair value £m
Assets				
Treasury bills and other eligible bills	9	9	530	523
Loans and advances to banks and customers	3,313	3,313	147,485	148,870
Debt securities and equity shares	15,351	15,351	13,776	13,885
Liabilities				
Deposits by banks and customers	807	807	139,644	139,695
Debt securities in issue	–	–	25,922	26,254
Subordinated liabilities	–	–	10,454	11,684

The disclosures in this note cover all on-balance sheet financial instruments; fair values of all derivative instruments are disclosed in note 47a.

Fair values are determined by reference to quoted market prices or, where no market price is available, using internal models which discount expected future cash flows at prevailing interest rates.

Fair values have not been calculated for sundry debtors and creditors in the trading book.

d Currency exposures

Structural currency exposures

The Group's main overseas operations are in the Americas and Europe. Details of the Group's structural foreign currency exposures are as follows:

Functional currency of Group operations	**2004 £m**	2003 £m
Euro	**289**	287
US dollar	**271**	255
Swiss franc	**58**	104
Other non-sterling	**202**	200
	820	846

Non-structural currency exposures

All foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled.

Information about the management of market risk in the Group's trading activities is given on pages 58 to 60.

e Unrecognised gains and losses on hedging instruments

The Group uses a variety of financial instruments to hedge exposures in its banking book; these hedges are accounted for on an accruals basis, in line with the underlying instruments being hedged. Any gains or losses that would occur if these instruments were carried at market value are therefore not recognised.

47 Derivatives and other financial instruments (continued)

At 31 December 2004, the unrecognised gains on financial instruments used for hedging were £272 million (2003: £303 million) and unrecognised losses were £424 million (2003: £219 million).

The net gains arising in 2003 and earlier years and recognised in 2004 amounted to £3 million. Net losses of £228 million arose in 2004 but were not recognised in the year.

Of the net losses of £152 million at 31 December 2004, £49 million of net losses are expected to be recognised in the year ending 31 December 2005 and £103 million of net losses in later years.

f Value at risk in trading activities

Details of value at risk in the Group’s global trading activities are given on page 59.

48 Acquisitions

During the year ended 31 December 2003, the Group completed the acquisition of the credit card and personal loan businesses of Goldfish Bank Limited, together with the Goldfish brand and loyalty programme, for a consideration of £1,096 million, settled in cash. The premium arising of £96 million from the effective payment to the majority shareholder was capitalised and is being written off to the profit and loss account over its estimated useful life of 10 years. No significant fair value adjustments were made.

During the year ended 31 December 2002, the Group’s asset finance operations completed the acquisitions of First National Vehicle Holdings and Abbey National Vehicle Finance, both previously wholly owned subsidiaries of Abbey National plc operating in the UK contract hire and fleet management market, and the business of the Dutton-Forshaw Group, a motor dealer; a number of fair value adjustments were made in respect of these acquisitions. In addition the Group’s retail operations acquired the business of Accucard, a credit card technology development and marketing company. Premiums on acquisition totalling £103 million were capitalised and are being written off to the profit and loss account over their estimated useful lives. Initial cash payments totalling £103 million were made in 2002; during 2003 a refund of £5 million was received in respect of First National Vehicle Holdings and Abbey National Vehicle Finance, following agreement of the completion accounts; and further payments of £1 million were made in respect of the Accucard business in each of 2003 and 2004.

49 Consolidated cash flow statement

The cash flow statement reflects cash flows attributable to the banking, life and general insurance businesses. Cash flows from long-term assurance business attributable to the shareholder include the surplus emerging from the life and pension businesses; 'Income from long-term assurance business' reflects the movement in the value of long-term assurance business attributable to the shareholder (see note 29) as adjusted for dividends. Cash flows relating to the long-term assurance business attributable to policyholders are not reflected within this statement.

a Reconciliation of operating profit to net cash inflow from operating activities

	2004 £m	2003 £m	2002 £m
Operating profit	**3,508**	3,505	2,629
(Increase) decrease in prepayments and accrued income	**(721)**	147	(21)
Increase (decrease) in accruals and deferred income	**732**	(226)	113
Provisions for bad and doubtful debts	**866**	950	1,029
Net advances written off	**(854)**	(967)	(675)
Insurance claims	**224**	236	233
Insurance claims paid	**(203)**	(231)	(210)
Customer remediation provision	**100**	200	–
Customer remediation paid	**(105)**	(119)	–
Amounts written off fixed asset investments	**52**	44	87
Income from long-term assurance business	**(715)**	(453)	294
Net charge in respect of defined benefit schemes	**267**	286	128
Contributions to defined benefit schemes	**(374)**	(138)	(37)
Interest on subordinated liabilities (loan capital)	**601**	622	537
Profit on disposal of investment securities	**(126)**	(47)	(160)
Depreciation and amortisation	**633**	697	701
Other non-cash movements	**(3)**	(131)	(120)
Net cash inflow from trading activities	**3,882**	4,375	4,528
Net increase in loans and advances	**(28,921)**	(11,710)	(11,970)
Net decrease (increase) in investments other than investment securities	**3,981**	248	(2,494)
Net decrease (increase) in other assets	**956**	816	(685)
Net increase (decrease) in deposits by banks	**15,864**	(1,000)	1,018
Net increase in customer accounts	**6,121**	7,658	6,900
Net increase in debt securities in issue	**1,859**	685	5,904
Net (decrease) increase in other liabilities	**(115)**	(645)	1,511
Net (increase) decrease in items in course of collection/transmission	**(13)**	169	147
Other non-cash movements	**(145)**	176	535
Net cash inflow from operating activities	**3,469**	772	5,394

b Analysis of cash as shown in the balance sheet

	2004 £m	2003 £m	2002 £m
Cash and balances with central banks	**1,078**	1,195	1,140
Loans and advances to banks repayable on demand	**2,477**	3,768	4,313
	3,555	4,963	5,453

The Group is required to maintain balances with the Bank of England which, at 31 December 2004, amounted to £187 million (2003: £177 million; 2002: £165 million).

c Analysis of changes in cash during the year

	2004 £m	2003 £m	2002 £m
At 1 January	**4,963**	5,453	3,683
Net cash (outflow) inflow before adjustments for the effect of foreign exchange movements	**(1,403)**	(487)	1,766
Effect of foreign exchange movements	**(5)**	(3)	4
At 31 December	**3,555**	4,963	5,453

49 Consolidated cash flow statement (continued)

d Analysis of changes in financing during the year	**2004 £m**	2003 £m	2002 £m
Share capital (including premium and merger reserve):			
At 1 January	**2,897**	2,852	2,713
Issue of share capital	**10**	45	139
At 31 December	**2,907**	2,897	2,852

The amounts shown as cash inflows from financing include proceeds in respect of the above issues of share capital together with a net cash inflow of £1 million (2003: outflow of £13 million; 2002: outflow of £62 million) relating to transactions in own shares held in respect of employee share schemes.

	2004 £m	2003 £m	2002 £m
Equity minority interests:			
At 1 January	**44**	37	37
Exchange and other adjustments	**–**	(1)	(1)
Minority share of profit after tax	**26**	22	19
Dividends paid to minority shareholders	**(24)**	(14)	(18)
At 31 December	**46**	44	37

	2004 £m	2003 £m	2002 £m
Non-equity minority interests:			
At 1 January	**683**	694	509
Exchange and other adjustments	**1**	23	18
Capital invested by minority shareholders	**–**	–	167
Repayment of capital to minority shareholders	**(132)**	–	–
Minority share of profit after tax	**42**	47	43
Payments to minority shareholders	**(44)**	(81)	(43)
At 31 December	**550**	683	694

	2004 £m	2003 £m	2002 £m
Subordinated liabilities and finance leases:			
At 1 January	**10,454**	10,169	8,111
Exchange and other adjustments	**(137)**	34	(5)
Issue of subordinated liabilities	**699**	533	2,120
Repayments of subordinated liabilities	**(764)**	(75)	(55)
Lease financing	**7**	–	–
Finance lease capital repayments	**(1)**	(1)	(4)
Adjustments on acquisition	**–**	–	2
Adjustments on disposal	**–**	(206)	–
At 31 December	**10,258**	10,454	10,169

e Acquisition of group undertakings and businesses	**2004 £m**	2003 £m	2002 £m
Cash consideration paid (see f)	**–**	1,096	103
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	**15**	14	14
Cash consideration refunded in respect of acquisition in 2002	**–**	(5)	–
Deferred consideration in respect of acquisition in 2002	**1**	1	–
Net cash outflow	**16**	1,106	117

49 Consolidated cash flow statement (continued)

f Acquisition of group undertakings	**2004 £m**	2003 £m	2002 £m
Net assets acquired:			
Loans and advances	**–**	993	66
Other assets	**–**	18	137
Tangible fixed assets	**–**	2	384
Deposits by banks, customer accounts and other liabilities	**–**	(13)	(590)
	–	1,000	(3)
Goodwill arising on consolidation	**–**	96	103
	–	1,096	100

The consideration of £1,096 million for the 2003 acquisitions was settled in cash in 2003; £103 million was paid in cash in 2002 in respect of the 2002 acquisitions, a refund of £5 million was received in 2003 and deferred payments of £1 million were made in each of 2003 and 2004 (See note 48).

g Disposal of group undertakings and businesses	**2004 £m**	2003 £m	2002 £m
Cash	**46**	52	–
Loans and advances to banks	**132**	1,035	–
Loans and advances to customers	**257**	13,770	–
Debt securities and treasury bills	**59**	852	–
Intangible assets	**10**	189	–
Deposits by banks	**(42)**	(519)	–
Customer accounts	**(327)**	(8,372)	–
Debt securities in issue	**(111)**	(5,108)	–
Subordinated liabilities	**–**	(206)	–
Other net assets (liabilities)	**9**	(305)	–
Goodwill written back on sale of businesses	**3**	181	–
	36	1,569	–
(Loss) profit on sale	**(15)**	865	–
Cash consideration received	**21**	2,434	–
Cash disposed of	**(46)**	(52)	–
Net cash (outflow) inflow from disposals	**(25)**	2,382	–

50 Differences between UK GAAP and US GAAP

The accounts presented in this report have been prepared in accordance with accounting principles generally accepted in the United Kingdom (UK GAAP). These differ in significant respects to the accounting principles generally accepted in the United States (US GAAP). The following is a summary of significant differences applicable to the Group.

UK GAAP	US GAAP
Business combinations	
UK GAAP permits merger accounting for business combinations where all of the following criteria are met: (1) no party is either portrayed as acquirer or acquired; (2) all parties participate in establishing the management structure; (3) one party does not dominate by virtue of its relative size; (4) consideration received by the equity shareholders of each party, in relation to their equity shareholding, comprises primarily equity shares in the combined entity; and (5) no equity shareholder retains any material interest in only part of the combined entity. Business combinations that do not satisfy all these criteria must be accounted for using acquisition accounting.	Following the implementation of Statement of Financial Accounting Standards (SFAS) No. 141 ‘Business Combinations’, which supersedes Accounting Principles Board (APB) Opinion No. 16 ‘Business Combinations’, the purchase method must be used for all business combinations initiated after 30 June 2001. For business combinations initiated before 1 July 2001, APB Opinion No. 16 required that a business combination be accounted for as a pooling-of-interests if two previously independent entities combined as a result of one entity issuing common stock in exchange for substantially all the common stock of the second entity. However, whilst the offer may include provisions to distribute cash for fractional shares or shares held by dissenting shareholders, it may not include a pro-rata distribution of cash or other consideration. In addition, no changes in the equity interests of the common stock may be made prior to the pooling in contemplation of the transaction and neither may the ratio of the interest of the individual common stockholder to those of other common stockholders in a combining company change as a result of the exchange of stock.
Goodwill/customer related intangibles	
Following the implementation of Financial Reporting Standard (FRS) 10 ‘Goodwill and intangible assets’ in 1998, goodwill arising on acquisitions of or by group and associated undertakings is capitalised and amortised over its estimated life. There is a presumption that the estimated life is limited to 20 years or less, although this may be rebutted and a longer or indefinite useful life considered. The directors consider that it is appropriate to assign an indefinite life to the goodwill which arose on the acquisition of Scottish Widows during 2000 in view of the strength of the Scottish Widows brand, developed through over 185 years of trading, and the position of the business as one of the leading providers of life, pensions, unit trust and fund management products; consequently it is not being amortised, however it is subject to annual impairment testing. For acquisitions prior to 1 January 1998 goodwill was charged directly against reserves as permitted by Statement of Standard Accounting Practice 22. This goodwill was not reinstated following the implementation of FRS 10, but in the event of a subsequent disposal it will be written back and included in the calculation of the profit or loss on disposal. UK GAAP does not require a value to be placed upon the customer relationships in acquisitions.	Following the implementation in full of SFAS No. 142 ‘Goodwill and Other Intangible Assets’ on 1 January 2002, goodwill arising on all acquisitions by group and associated undertakings is capitalised but no longer amortised and is subject to regular review for impairment. Prior to the adoption of SFAS No. 142, the Group accounted for goodwill under the provisions of APB No. 17 ‘Intangible Assets’ which required that all goodwill be capitalised and amortised over its estimated useful life, which should not exceed 40 years; the Group amortised goodwill over periods of up to 20 years. Goodwill amortised prior to the adoption of SFAS No. 142 is not permitted to be reinstated. For acquisitions occurring on or after 1 July 2001, SFAS No. 141 requires that, when assessing the value of the assets of an acquired entity, certain identifiable intangible assets must be recognised. Such identifiable intangible assets include the asset representing the value of customer relationships, which is capitalised separately and amortised through the income statement over the estimated average life of the customer relationships. Prior to 1 July 2001, the Group applied the provisions contained within SFAS No. 72 ‘Accounting for Certain Transactions of Bank and Thrift Institutions’ in assessing the value of assets of an acquired financial institution.

50 Differences between UK GAAP and US GAAP (continued)

UK GAAP	US GAAP
Pension costs	
For defined benefit schemes, pension costs in the profit and loss account reflect the cost of accruing benefits for active employees, benefit improvements and the cost of severances borne by the schemes; the expected return on scheme assets, net of a charge in respect of the unwinding of the discount applied to scheme liabilities, is included in the profit and loss account as other finance income. Actuarial gains and losses, including differences between the expected and actual return on scheme assets, are recognised as they arise, net of deferred tax, in the statement of total recognised gains and losses. Scheme assets are assessed at fair value and scheme liabilities are measured on an actuarial basis using the projected unit method and are discounted at the current rate of return on a high quality corporate bond of equivalent currency and term. The overall surplus or deficit is included on the balance sheet, net of the related deferred tax. Costs in relation to defined contribution schemes are charged to the profit and loss account in the period in which they fall due.	SFAS No. 87 'Employers' Accounting for Pensions' prescribes a similar method but allows that a certain portion of actuarial gains and losses be deferred and allocated in equal amounts over the average remaining service lives of the current employees. In addition, if the fair value of plan assets falls below the accumulated benefit obligation (which is the current value of accrued benefits without allowance for future salary increases) an additional minimum liability must be recognised. An equal amount should be recognised as an intangible asset up to the amount of any unrecognised prior service cost. Any amount not recognised as an intangible asset is reported in other comprehensive income, net of deferred tax. US GAAP also requires a transition adjustment for pension schemes in place before the introduction of SFAS No. 87. The difference between the funded status of the schemes and the total amount of accrued or prepaid pension cost, at the date of transition, is amortised over the average remaining service lives of employees at that date.
Leasing	
Finance lease income is recognised in proportion to the funds invested in the lease using a method that results in a constant rate of return on the net cash investment, which takes into account tax payments and receipts. Operating lease assets are depreciated such that rentals less depreciation are recognised at a constant periodic rate of return on the net cash invested in that asset. Profits or losses arising on sale and leasebacks are taken to profit as they arise.	The application of SFAS No. 13 'Accounting for Leases' gives rise to a level rate of return on the investment in the lease, but without taking into account tax payments and receipts. This results in income being recognised in different periods than under UK GAAP. Operating lease assets are depreciated such that the depreciation charge is at least equal to that which would arise on a straight line basis. Under SFAS No. 28 'Accounting for Sales with Leasebacks' profits or losses arising on a sale and leaseback are deferred and amortised. For leasebacks resulting in a finance lease, the amounts are amortised in proportion to the amortisation of the leased asset; for leasebacks resulting in an operating lease, the amounts are amortised in proportion to the gross rental charged to expense over the lease term.
Property	
Depreciation is charged on the cost of freehold and long leasehold properties over their estimated useful economic lives. Following the adoption of FRS 15, the Group reassessed the useful economic lives and residual values of its freehold and long leasehold premises and, with effect from 1 January 2000, the cost of these properties, after deducting the value of the land, is being depreciated over 50 years. Previously it was considered that the residual values were such that depreciation was not significant.	Freehold and long leasehold properties are included in the balance sheet at historical cost and depreciated over their estimated useful economic lives from the date of acquisition.
Share compensation schemes	
No cost is recognised for the Group's Save-As-You-Earn schemes as these are exempt under UITF17. For other share schemes, the difference between the market price and exercise price at the date of grant is charged to the profit and loss account on a systematic basis over the period that the employees are expected to benefit.	The Group accounts for share compensation schemes based on their estimated fair values at the date of the grant in accordance with SFAS No. 123 'Accounting for Stock Based Compensation'.

UK GAAP	US GAAP
Computer software developed or obtained for internal use	
All computer software costs are expensed as incurred except for operating software and application software relating to separable new systems, which are capitalised and depreciated over their estimated useful lives. All enhancements are expensed as incurred.	The American Institute of Certified Public Accountants (AICPA) Statement of Position 98-1 'Accounting for the costs of computer software developed or obtained for internal use' requires certain costs incurred from 1 January 1999 in respect of software developed for internal use to be capitalised and subsequently amortised. This includes enhancements to existing systems which add additional functionality.
Derivatives	
Derivatives used in the Group's trading activities are carried at fair value and all changes in fair value are reported within dealing profits in the profit and loss account. Derivatives used in the Group's non-trading activities are accounted for on an accruals basis, in line with the treatment of the underlying items which they are hedging. A derivative will only be classified as a hedge in circumstances where there was adequate evidence of the intention to hedge at the outset of the transaction and the derivative substantially matches or eliminates the exposure being hedged. Derivatives embedded within financial instruments are not required to be separately analysed.	SFAS No. 133 'Accounting for Derivative Instruments and for Hedging Activities' requires that all derivatives be recognised on-balance sheet at fair value. Changes in the fair value of derivatives that are not hedges are reported in the income statement. For derivatives which are hedges, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognised in other comprehensive income until the hedged item is recognised in earnings. The ineffective portion of a hedge's change in fair value is immediately recognised in earnings. A derivative will only be classified as a hedge providing an entity meets stringent qualifying criteria in respect of documentation and hedge effectiveness. SFAS No. 133 further requires a derivative that is embedded within a financial instrument to be separated from the host contract and fair valued if it is not deemed to be clearly and closely related to the host. If the derivative cannot be reliably separated, SFAS No. 133 requires the entire instrument to be fair valued.
Foreign currency translation	
The assets, liabilities and results of the Group's overseas operations are translated into sterling at the rate of exchange prevailing at the balance sheet date, as permitted under UK GAAP.	Under SFAS No. 52 'Foreign Currency Translation', foreign currency assets and liabilities are translated at the year-end rate; however, results are translated at the average rate for the year.
Investment securities	
Debt securities and equity shares intended for use on a continuing basis by the Group are treated as investment securities and included in the balance sheet at cost as adjusted for the amortisation of any premiums and discounts arising upon acquisition, less provision for any permanent diminution in value.	SFAS No. 115 'Accounting for Certain Investments in Debt and Equity Securities' requires that debt securities which are 'available-for-sale' (where there is the absence of either the intent or the ability to hold them to maturity) and equity shares with a readily determinable market value should be recorded at fair value with unrealised gains and losses reflected in shareholders' equity. All debt securities held as available-for-sale are subject to assessment for other than temporary impairment in accordance with SFAS No. 115 and, for asset backed securities, in accordance with the Emerging Issues Task Force (EITF) Abstract No. 99-20 'Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitised Financial Assets'.
Dividends payable	
Dividends declared after the period end are recorded in the period to which they relate.	Dividends are recorded in the period in which they are declared.
Acceptances	
Acceptances are not recorded on the balance sheet.	Acceptances and the related customer liabilities are recorded on the balance sheet.

50 Differences between UK GAAP and US GAAP (continued)

UK GAAP	US GAAP
Own shares	
Own shares held are deducted from equity. Own shares that are held by the Group's long-term assurance funds are recognised to the extent of the shareholder's interest, which is 10 per cent.	All own shares held are reclassified as Treasury stock and deducted from shareholders' equity in accordance with the AICPA Accounting Research Bulletin (ARB) No. 51 'Consolidated Financial Statements'.
Deferred tax	
Deferred tax is provided for all timing differences between the recognition of gains and losses in the financial statements and their recognition in a tax computation. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted. Deferred tax is provided based on the rates that have been enacted or have been substantially enacted.	Under SFAS No. 109 'Accounting for Income Taxes', deferred tax assets and liabilities are recorded for all temporary differences. A valuation allowance is recorded against a deferred tax asset where it is more likely than not that some portion of the deferred tax asset will not be realised. Deferred tax is provided on enacted tax rates. SFAS No. 109 requires provisions to be raised on the portion of unremitted foreign earnings that are not considered to be permanently reinvested in the foreign subsidiary.
Provision for credit losses	
A specific provision is made to cover the estimated loss as soon as the recovery of an outstanding loan is considered doubtful. Provisions are calculated as the difference between the carrying value of loans and the expected recoverable amount; no allowance is made for the time value of money. General provisions are raised to cover losses incurred but not yet identified as of the balance sheet date.	SFAS No. 114 'Accounting by Creditors for Impairment of a Loan' requires the overall credit risk provision to be determined based upon the present value of expected future cash flows, discounted at the loan's effective interest rate or, as a practical expedient, on the loan's observable market value, or the fair value of the collateral if the loan is collateral dependent. Smaller balance homogeneous consumer loans that are collectively valued for impairment are outside the scope of SFAS No. 114, as are debt securities and leases. General provisions are made against such loans when losses have been incurred but not yet identified as of the balance sheet date.
Consolidation of special purpose vehicles	
Entities that fall within the definition of quasi-subsidiaries as set out in FRS5 have been consolidated. A quasi-subsidiary is defined as an entity which, although it does not fulfil the definition of a subsidiary, is directly or indirectly controlled by Lloyds TSB Group.	FIN 46-R requires the consolidation of variable interest entities (VIEs) for which Lloyds TSB Group is deemed to be the primary beneficiary. A more detailed discussion of VIEs can be found on pages F-84 to F-85.
Insurance activities	
The shareholder's interest in the long-term assurance fund is valued at the net present value of the profits inherent in such policies.	The net present value of the profits inherent in the policies of the long-term assurance fund is not recognised. An adjustment is made for the amortisation of acquisition costs and fees. Additional information on the differences between the UK and US accounting for insurance activities is provided within the Insurance section of this note on pages F-86 to F-89.

Current and future accounting developments

United States

AICPA Statement of Position (SOP) 03-1 – Accounting and Reporting by Insurance Enterprises for Certain Non-Traditional Long-Duration Contracts and for Separate Accounts

SOP 03-1 was issued in July 2003 and provides guidance on accounting and reporting by insurance enterprises for certain non-traditional long-duration contracts and for separate accounts. The SOP became effective for Lloyds TSB Group from 1 January 2004 and has been adopted on a prospective basis. See note p.

EITF 03-1 –The meaning of Other-Than-temporary Impairment and its Application to Certain Investments

The EITF Issue 03-1 (EITF 03-1) provides guidance on recognising other-than-temporary impairments on securities classified as either available-for-sale or held-to-maturity under SFAS 115 and for investments accounted for under the amortised cost method. In September 2004, the FASB issued FASB Staff Position (FSP) EITF 03-1-1 which delayed the effective date of EITF 03-1 until the FASB staff addresses additional measurement issues affecting the consensus.

AICPA SOP 03-3 – Accounting for Certain Loans or Debt Securities Acquired in a Transfer

SOP 03-3 was issued in December 2003 and provides guidance on the accounting for differences between contractual and expected cash flows from a purchaser’s initial investment in loans or debt securities acquired in a transfer if those differences are attributable to credit quality. The SOP is effective for loans acquired in fiscal years beginning after 15 December 2004. Adoption of this SOP is not expected to have a material impact on Lloyds TSB Group’s US GAAP financial statements.

SAB 105 – Application of Accounting Principles to Loan Commitments

In March 2004, the SEC issued Staff Accounting Bulletin No. 105 (SAB 105). The SAB addresses the initial recognition and measurement of loan commitments that meet the definition of a derivative. The SAB is effective for all applicable loan commitments entered into, or substantially modified, on or after 1 April 2004. The adoption of SAB 105 did not have a material impact on Lloyds TSB Group’s US GAAP financial statements.

SFAS 123 (Revised 2004) – Share-Based Payment

On 16 December 2004, the FASB issued Statement 123(R), effective as of the first interim or annual reporting period that begins after 15 June 2005; this effective date has been amended for SEC registrants to the beginning of the fiscal year beginning after 15 June 2005. Statement 123(R) replaces SFAS No. 123, Accounting for Stock-Based Compensation, supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. As Lloyds TSB Group has already elected to follow the fair value method encouraged by SFAS 123 in its US GAAP financial statements, adoption of this Statement is not expected to have a material impact.

SFAS 153 – Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions

In December 2004, the FASB issued SFAS No. 153 which is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after 15 June 2005. This Statement provides for a general exception from fair value measurement for exchanges of non-monetary assets that do not have commercial substance. Adoption of this Statement is not expected to have a material impact on Lloyds TSB Group’s US GAAP financial statements.

FSP FIN46(R)-5 – Implicit Variable Interests under FASB Interpretation No. 46(R) Consolidation of Variable Interest Entities

FSP FIN46(R)-5 was issued in March 2005 and addresses whether a reporting entity has an implicit variable interest in a variable interest entity or potential variable interest entity when specific conditions exist. Implicit variable interests are implied financial interests in an entity that change with changes in the fair value of the entity’s net assets exclusive of variable interests. This FSP is effective for the first reporting period beginning after 3 March 2005. Adoption is not expected to have a material impact on Lloyds TSB Group’s US GAAP financial statements.

SFAS 154 – Accounting Changes and Error Correction – a replacement of APB Opinion No.20 and FASB Statement No. 3

SFAS 154 was issued in May 2005 and is effective for accounting changes and corrections of errors made in fiscal years beginning after 15 December 2005. SFAS 154 provides guidance on the accounting for and reporting of accounting changes (voluntary and those required by the issuance of an accounting pronouncement) and error corrections. APB Opinion No.20 previously required that most voluntary changes in accounting principle be recognised by including in net income, in the period of the changes, the cumulative effect of changing to the new accounting principle. SFAS 154 establishes, unless impracticable, retrospective application of the direct effects of the change as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. The correction of an error in previously issued financial statements is not an accounting change although the reporting of an error correction involves adjustments to previously issued financial statements similar to those for reporting an accounting change. Adoption of this Statement by Lloyds TSB Group in its US GAAP financial statements is not expected to have a material impact.

50 Differences between UK GAAP and US GAAP (continued)

The following tables summarise the adjustments to net income and shareholders' equity which would arise from the application of US GAAP:

Reconciliation of net income

	Note	**2004 £m**	2003 £m	2002 £m
Profit for the year attributable to shareholders under UK GAAP		**2,421**	3,254	1,790
Insurance activities, excluding tax effects	p	**(42)**	(160)	(393)
Banking and Group activities:				
– Goodwill amortisation	a	**44**	51	72
– Adjustment to result on sale of businesses	b	**(5)**	(12)	–
– Amortisation of customer related intangibles	a	**(157)**	(150)	(193)
– Pension costs	c	**(137)**	143	113
– Leasing		**(74)**	(37)	(109)
– Property depreciation		**2**	–	4
– Share compensation schemes	d	**(23)**	(113)	(44)
– Internal software costs		**(4)**	(17)	6
– Derivatives	f	**(60)**	172	305
– Variable interest entities	l	**14**	–	–
– Foreign currency translation differences		**5**	(4)	12
Total banking and Group activities, excluding tax effects		**(395)**	33	166
Taxation:				
– Deferred taxation	i	**4**	21	25
– Deferred taxation on GAAP differences	i	**74**	83	165
Total taxation		**78**	104	190
Total adjustments before accounting changes		**(359)**	(23)	(37)
Net income before accounting changes		**2,062**	3,231	1,753
Cumulative effect of changes in accounting principles (net)	p, l	**(554)**	–	–
Net income under US GAAP		**1,508**	3,231	1,753

Reconciliation of shareholders' equity

	Note	**2004 £m**	2003 £m
Shareholders' funds under UK GAAP		**9,977**	9,624
Insurance activities, excluding tax effects	p	**(456)**	(66)
Banking and Group activities:			
– Goodwill	a	**1,262**	1,218
– Customer related intangibles	a	**378**	535
– Pension costs	c	**1,003**	971
– Leasing		**(494)**	(420)
– Property depreciation		**(43)**	(45)
– Internal software		**28**	41
– Derivatives	f	**19**	76
– Net unrealised gain on available-for-sale securities	g	**36**	109
– Variable interest entities	l	**(316)**	–
– Dividend payable		**1,315**	1,314
– Own shares related items	h	**(185)**	(195)
Total banking and Group activities, excluding tax effects		**3,003**	3,604
Taxation:			
– Deferred taxation	i	**(35)**	(39)
– Deferred taxation on GAAP differences	i	**(1,031)**	(1,231)
Total taxation		**(1,066)**	(1,270)
Total adjustments, after tax		**1,481**	2,268
Shareholders' equity under US GAAP		**11,458**	11,892

50 Differences between UK GAAP and US GAAP (continued)

Reconciliation of movements in shareholders' equity under US GAAP

	2004 £m	2003 £m	2002 £m
Net income in period	**1,508**	3,231	1,753
Dividends	**(1,913)**	(1,908)	(1,903)
	(405)	1,323	(150)
New share capital subscribed	**10**	45	139
Movement in own shares	**8**	(31)	35
Share compensation schemes	**35**	113	44
Minimum pension liability	**(48)**	53	(3,277)
Change in the fair value of available-for-sale securities – insurance activities	**31**	8	15
Change in the fair value of available-for-sale securities – banking activities	**(51)**	54	(147)
Exchange and other adjustments	**(14)**	163	–
	(434)	1,728	(3,341)
Shareholders' equity at beginning of period	**11,892**	10,164	13,505
Shareholders' equity at end of period	**11,458**	11,892	10,164

Accumulated other comprehensive income

	2004 £m	2003 £m	2002 £m
Exchange translation differences	**(172)**	(158)	(321)
Additional minimum pension liability	**(3,272)**	(3,224)	(3,277)
Available-for-sale securities:			
– Net unrealised gains – insurance activities	**314**	182	245
– Related amortisation of deferred acquisition costs	**(211)**	(125)	(197)
– Net unrealised gains – banking activities	**36**	109	32
– Taxation	**(42)**	(49)	(25)
	97	117	55
Accumulated other comprehensive income under US GAAP	**(3,347)**	(3,265)	(3,543)

50 Differences between UK GAAP and US GAAP (continued)

Condensed US GAAP Profit and loss account

The following table provides a condensed profit and loss account for the Group, incorporating the US GAAP adjustments arising.

	2004 **£m**	2003 £m	2002 £m
Loan interest, including fees	**10,380**	8,341	7,937
Other interest and dividends	**2,453**	1,771	2,035
Insurance premiums	**1,871**	2,042	2,015
Commissions and fees	**2,049**	2,328	2,171
Realised gains from sales of investments	**142**	89	163
Foreign exchange trading income	**178**	193	149
Securities and other trading gains (losses)	**2,678**	1,021	(2,370)
Other income	**2,511**	1,755	1,881
Total revenues	**22,262**	17,540	13,981
Interest expense	**5,594**	4,106	4,123
Total revenues, net of interest expense	**16,668**	13,434	9,858
Policyholder benefits and claims expense	**4,473**	3,036	1,565
Movement in undistributed earnings to policyholders	**777**	(100)	(1,518)
Provisions for bad and doubtful debts	**866**	887	978
Amounts written off fixed asset investments	**52**	44	87
Total benefits, claims and provisions	**6,168**	3,867	1,112
Non-insurance compensation and benefits	**2,547**	2,306	2,418
Insurance underwriting, operating and acquisition expenses	**583**	578	766
Other operating expenses	**3,108**	2,619	1,828
Depreciation	**628**	713	749
Amortisation of intangible fixed assets:			
– Customer related intangibles	**157**	150	193
– Value of long-term assurance business acquired	**243**	188	725
	400	338	918
	7,266	6,554	6,679
Income before tax from continuing operations	**3,234**	3,013	2,067
Provision for income taxes (continuing operations)*	**928**	832	495
Minority interests, net of income taxes	**226**	26	62
Discontinued operations:			
– Income from discontinued operations	**–**	354	311
– (Loss) profit on sale of businesses	**(20)**	853	–
– Provision for income taxes	**2**	(89)	(81)
	(18)	1,118	230
Cumulative effect of changes in accounting principles (net)	**(554)**	(42)	13
Net income under US GAAP	**1,508**	3,231	1,753
Exchange translation and other differences	**(14)**	163	–
Minimum pension liability	**(48)**	53	(3,277)
Available-for-sale securities:			
– Net unrealised gains (losses) – insurance activities	**132**	(63)	196
– Related amortisation of deferred acquisition costs	**(86)**	72	(174)
– Net unrealised (losses) gains – banking activities	**(73)**	77	(210)
– Taxation	**7**	(24)	56
	(20)	62	(132)
Comprehensive income under US GAAP	**1,426**	3,509	(1,656)
Earnings per share (pence)	**27.0p**	57.9p	31.5p
Diluted earnings per share (pence)	**26.8p**	57.7p	31.3p

* Significant items affecting the Group's effective tax rate under US GAAP include the fact that tax is levied on UK life assurance and pension businesses under specialised rules not based on the profit and loss account. In addition, under US GAAP a tax provision is required for unrealised gains that are attributable to the policyholders. The amount provided will vary depending upon the fluctuations of the stock market and this movement can result in significant changes in the effective rate of tax.

50 Differences between UK GAAP and US GAAP (continued)

Condensed US GAAP Balance sheet

The following table provides a condensed balance sheet for the Group, incorporating the US GAAP adjustments arising.

	2004 £m	2003 £m
Assets		
Cash and due from banks	**10,287**	9,364
Deposits at interest with banks	**13,410**	10,219
Securities purchased under resale agreements	**12,780**	2,642
Treasury bills and other eligible bills	**88**	530
Trading and other investments	**55,751**	36,627
Investment securities	**19,944**	19,045
Loans, net of provisions	**152,428**	134,043
Tangible fixed assets	**4,306**	3,842
Intangible fixed assets:		
– Goodwill	**3,862**	3,731
– Customer related intangibles	**378**	535
– Value of long-term assurance business acquired	**1,587**	2,094
– Pension liability related intangible	**233**	231
Deferred acquisition costs	**1,310**	1,048
Separate account assets	**–**	22,494
Other assets	**5,234**	4,713
Total assets	**281,598**	251,158
Liabilities		
Deposits	**159,546**	140,451
Trading account liabilities	**3,135**	3,500
Debt securities in issue	**28,562**	25,922
Policyholder liabilities	**51,962**	25,080
Undistributed policyholder allocations	**1,505**	1,772
Commitments and contingencies	**211**	216
Deferred tax	**1,370**	1,444
Long-term debt	**10,802**	11,003
Separate account liabilities	**–**	22,494
Other liabilities	**10,306**	7,330
Minority interests	**2,741**	54
Total liabilities	**270,140**	239,266
Shareholders' equity:		
– Common stock	**1,419**	1,418
– Additional paid-in capital	**5,048**	5,003
– Retained earnings	**8,523**	8,929
– Treasury stock	**(185)**	(193)
– Accumulated other comprehensive income	**(3,347)**	(3,265)
Total shareholders' equity	**11,458**	11,892
Total liabilities and shareholders' equity	**281,598**	251,158

50 Differences between UK GAAP and US GAAP (continued)

Condensed Consolidated statement of cash flows in accordance with SFAS No. 95

	2004 £m	2003 £m	2002 £m
Cash flows from operating activities			
Net income before minority interests and effect of accounting changes	**2,287**	3,299	1,802
Adjustments required to reconcile net income to net cash provided by operating activities:			
Amortisation of intangible fixed assets	**400**	338	918
Depreciation of tangible fixed assets	**628**	726	761
Provision for bad and doubtful debts, net of write-offs	**12**	(17)	354
Change in trading and other investments	**3,283**	4,309	(3,176)
Change in trading account liabilities	**(365)**	(2,083)	2,107
Change in deferred acquisition costs	**(290)**	(202)	(51)
Change in other assets	**17**	1,760	(91)
Change in policyholder liabilities	**3,208**	1,365	(97)
Change in undistributed policyholder allocations	**789**	(118)	(1,588)
Change in other liabilities	**2,830**	(2,779)	(266)
Net gain on sale of investment securities	**(142)**	(89)	(163)
Loss (profit) on disposal of businesses	**20**	(853)	–
Profit on disposal of tangible fixed assets	**(11)**	(43)	(47)
Other, net	**(10)**	884	152
Total adjustments	**10,369**	3,198	(1,187)
Net cash provided by operating activities	**12,656**	6,497	615
Cash flows from investing activities			
Change in deposits at interest with banks	**(1,171)**	1,587	102
Change in securities purchased under resale agreements	**(10,138)**	(946)	(313)
Change in loans and advances to customers	**(18,214)**	(12,342)	(11,743)
Purchases of investment securities	**(12,992)**	(40,763)	(47,885)
Proceeds from sale and maturity of investment securities	**11,791**	39,312	46,880
Purchases of tangible fixed assets	**(1,212)**	(799)	(1,352)
Proceeds from sale of tangible fixed assets	**243**	330	359
Additions to interests in joint ventures	**–**	(12)	(21)
Acquisition of subsidiary undertakings and businesses	**(16)**	(1,106)	(117)
Disposal of subsidiary undertakings and businesses	**(25)**	2,382	–
Net cash used in investing activities	**(31,734)**	(12,357)	(14,090)
Cash flows from financing activities			
Dividends paid – equity	**(1,913)**	(1,908)	(1,903)
Dividends paid to minorities – equity	**(24)**	(14)	(18)
Dividends paid to minorities – non-equity	**(201)**	(38)	(43)
Cash proceeds from issue of ordinary share capital and transactions in treasury stock	**11**	32	77
Issue of long-term debt	**699**	533	2,120
Redemption of long-term debt	**(764)**	(75)	(55)
Minority investment in subsidiaries	**–**	–	167
Repayment of third party capital investment	**(132)**	–	–
Change in deposits	**19,731**	6,388	7,925
Change in short-term borrowings	**2,418**	1,807	5,969
Policyholders’ deposits	**4,202**	1,039	1,602
Policyholders’ withdrawals	**(4,026)**	(1,087)	(1,207)
Net cash provided by financing activities	**20,001**	6,677	14,634
Change in cash and cash equivalents	**923**	817	1,159
Cash and cash equivalents at beginning of period	**9,364**	8,547	7,388
Cash and cash equivalents at end of period	**10,287**	9,364	8,547
Cash paid during the year for income taxes	**763**	784	951
Cash paid during the year for interest	**5,107**	5,066	5,321

50 Differences between UK GAAP and US GAAP (continued)

Balance sheet presentation

Certain classification differences exist in financial reporting under UK GAAP and US GAAP. For the Group, such differences primarily arise in the balance sheet and the following comparison lists the line items in which such differences occur.

UK GAAP	US GAAP
Cash and balances at central banks	Cash and due from banks
Items in course of collection from banks	Cash and due from banks
Treasury bills and other eligible bills	Classified as 'Trading and other investments' where appropriate
Loans and advances to banks	Loans to banks due on demand classified as 'Cash and due from banks'; Reverse repos classified as 'Securities purchased under resale agreements'
Loans and advances to customers	Reverse repos classified as 'Securities purchased under resale agreements'
Debt securities	Classified as 'Trading and other investments' and 'Investment securities' where appropriate
Equity shares	Classified as 'Trading and other investments' and 'Investment securities' where appropriate
Other assets	Classified as 'Trading and other investments' where appropriate
Prepayments and accrued income	Other assets
Items in course of transmission to banks	Cash and due from banks
Debt securities in issue	Classified as 'Trading account liabilities' where appropriate
Other liabilities	Classified as 'Trading account liabilities' where appropriate
Accruals and deferred income	Other liabilities
Other provisions for liabilities and charges	Commitments and contingencies
Subordinated liabilities	Long-term debt
Merger reserve	Classified as 'Additional paid-in capital'
Long-term assurance business	Classifications are discussed on pages F-86 to F-89

Consolidated statement of cash flows

The Group's UK GAAP cash flow statement on page F-7 is prepared under the provisions of FRS 1 (Revised). This is similar in many respects to SFAS No. 95 'Statement of Cash Flows', as amended by SFAS No. 104 'Statement of Cash Flows – Net Reporting of Certain Cash Receipts and Cash Payments and Classification of Cash Flows from Hedging Transactions'. Two principal differences arise between the standards with regard to the definition of cash and the classification of items within the cash flow statement.

FRS 1 (Revised) defines cash as cash in hand and repayable on demand. Under SFAS No. 95, cash and cash equivalents are defined as short-term, highly liquid investments that are both readily convertible to known amounts of cash; and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

For the purposes of SFAS No. 95, the Group's cash and cash equivalents of £10,287 million (2003: £9,364 million; 2002: £8,547 million) comprise items reported under the following UK balance sheet categories: cash and balances at central banks; items in the course of collection from banks; loans and advances to banks repayable on demand and items in the course of transmission to banks. Under UK GAAP the results, assets and liabilities of the long-term assurance business are presented on a one-line basis and accordingly movements in cash flows are aggregated into one line within the reconciliation of operating profit. Under US GAAP, the insurance activities have been disaggregated and accordingly the cash flows have been allocated to the appropriate line items within the cash flow statement. Cash attributable to the long-term assurance business is included within cash and cash equivalents above.

Differences between UK and US GAAP with regard to classification of items within the cash flow statement are summarised below:

Cash flow	Classification under FRS 1 (Revised)	Classification under SFAS No. 95
Net change in loans and advances, including lease financing	Operating activities	Investing activities
Net change in deposits and debt securities in issue	Operating activities	Financing activities
Dividends paid to equity and non-equity minority interests	Returns on investments and servicing of finance	Financing activities
Tax paid	Taxation	Operating activities
Capital expenditure and financial investment	Capital expenditure and financial investment	Investing activities
Purchases/proceeds from disposal of subsidiary and associated undertakings	Acquisitions and disposals	Investing activities
Dividends paid – equity	Equity dividends paid	Financing activities

Under FRS 1 (Revised), transactions designated as hedges are reported under the same heading as the related assets or liabilities. The restrictions in respect of cash and balances at central banks are disclosed on page F-56.

Notes to the UK/US GAAP reconciliation

a Goodwill and customer related intangible assets

Under UK GAAP on 1 January 1998, the Group adopted FRS 10, 'Goodwill and Intangible Assets'. In respect of acquisitions since 1 January 1998, goodwill is included in the consolidated balance sheet under intangible fixed assets and amortised over its estimated useful economic life on a straight-line basis. Prior to 1 January 1998, the Group charged goodwill directly against reserves. In the case of the acquisition of Scottish Widows in 2000, in view of the strength of the Scottish Widows brand and the position of the business as one of the leading providers of life, pensions, unit trust and fund management products, the directors consider that it is appropriate to assign an indefinite life to the goodwill. This goodwill is not being amortised through the profit and loss account; however it is subjected to annual impairment reviews in accordance with FRS 11 'Impairment of Fixed Assets and Goodwill'. Should any impairment be identified, it would be charged to the profit and loss account immediately.

Under US GAAP, from 1 January 2002 the Group adopted the remaining provisions of SFAS No. 142 and accordingly all goodwill arising in respect of acquisitions is capitalised but no longer amortised and is subject to regular review for impairment; in periods prior to 1 January 2002, goodwill arising in respect of acquisitions was amortised over periods of up to 20 years. Goodwill amortised prior to the full adoption of SFAS No. 142 is not permitted to be reinstated.

The Group has performed the required impairment tests under UK and US GAAP and no impairments were recorded against goodwill during 2002, 2003 or 2004.

The treatment of the Group's major acquisitions is detailed below:

Abbey Life

In 1988, Lloyds Bank Plc transferred a minority interest in five businesses to Abbey Life Group plc, a life insurance company, in return for a majority interest in the enlarged Abbey Life Group. Under UK GAAP, this transaction was accounted for as a merger. Under US GAAP, the same transaction would be accounted for as an acquisition. Accordingly the net assets of Abbey Life Group plc (later renamed Lloyds Abbey Life plc) have been fair valued in accordance with US GAAP and a purchase price determined based on the fair value of the minority interest transferred. In 1996, Lloyds TSB Group plc acquired the remaining minority interest in Lloyds Abbey Life plc. Under UK and US GAAP the transaction is treated as an acquisition. However, certain differences arise under US GAAP regarding the determination of fair value of life insurance companies and accordingly an adjustment has been made for the items affected.

Cheltenham & Gloucester

Under UK and US GAAP, the purchase of the business of Cheltenham & Gloucester Building Society by Lloyds Bank Plc in August 1995 is treated as an acquisition. Certain differences arise under US GAAP regarding the fair value of the net assets. In addition, the net assets acquired include £521 million relating to customer related intangibles, which has been amortised over 7 years.

TSB Group plc

The business combination of Lloyds Bank Plc and TSB Group plc in December 1995 was accounted for as a merger as permitted under UK GAAP at that time, although legally TSB Group plc was deemed to have acquired Lloyds Bank Plc. Under US GAAP, the same transaction would have been accounted for as an acquisition of TSB Group plc by Lloyds Bank Plc. Accordingly, for US GAAP, the net assets of TSB Group plc have been fair valued as at the date of the business combination and a purchase price determined based on the value of TSB Group plc shares at that time. The net assets include £1,596 million relating to customer related intangibles, which is being amortised over 11 years.

Scottish Widows

In March 2000, the Group acquired the business of Scottish Widows' Fund and Life Assurance Society, a life insurance and pensions provider. Under UK and US GAAP, the purchase is treated as an acquisition. However certain differences arise under US GAAP regarding the determination of fair value of the life insurance business, and certain other differences between UK and US GAAP such as the treatment of pensions and own shares, for which adjustments have been made.

50 Differences between UK GAAP and US GAAP (continued)

The movement in US GAAP goodwill is summarised as follows:

	2004 UK GAAP £m	2004 US GAAP adjustment £m	2004 US GAAP £m	2003 UK GAAP £m	2003 US GAAP adjustment £m	2003 US GAAP £m
Cost						
Balance at 1 January	**2,626**	**2,156**	**4,782**	2,771	2,325	5,096
Acquisition adjustment	**(34)**	**–**	**(34)**	–	–	–
Exchange and other adjustments	**–**	**–**	**–**	32	11	43
Acquisitions	**–**	**–**	**–**	96	(96)	–
Disposals	**(14)**	**–**	**(14)**	(273)	(84)	(357)
Adoption of FIN 46-R (see note l)	**–**	**175**	**175**	–	–	–
Balance at 31 December	**2,578**	**2,331**	**4,909**	2,626	2,156	4,782
Amortisation						
Balance at 1 January	**(113)**	**(938)**	**(1,051)**	(137)	(978)	(1,115)
Exchange and other adjustments	**–**	**–**	**–**	(9)	(3)	(12)
Charge for the year	**(44)**	**44**	**–**	(51)	51	–
Disposals	**4**	**–**	**4**	84	(8)	76
Balance at 31 December	**(153)**	**(894)**	**(1,047)**	(113)	(938)	(1,051)
Net book value	**2,425**	**1,437**	**3,862**	2,513	1,218	3,731

Within the reconciliation of shareholders' equity on page F-64, the £175m US GAAP adjustment in respect of the adoption of FIN 46-R is included within the variable interest entities item.

The movement in goodwill by segment over 2004 is as follows:

	Balanceat 1 January £m	Exchange movements £m	Disposals £m	Other adjustments £m	Balanceat 31 December £m
UK Retail Banking and Mortgages	**660**	**–**	**–**	**–**	**660**
Insurance and Investments	**2,194**	**–**	**–**	**(34)**	**2,160**
Wholesale and International Banking	**877**	**–**	**(10)**	**175**	**1,042**
	3,731	**–**	**(10)**	**141**	**3,862**

Under US GAAP, the intangible asset representing the value of customer relationships associated with an acquisition is capitalised separately and amortised in the consolidated income statement over the estimated average life of the customer relationships. At 31 December 2004, the weighted average remaining life of those relationships is estimated as 3 years.

The movement in customer related intangible assets is summarised as follows:

	2004 £m	2003 £m
Cost		
Balance at 1 January	**2,223**	2,127
Additions	**–**	96
Balance at 31 December	**2,223**	2,223
Amortisation		
Balance at 1 January	**1,688**	1,538
Charge for the year	**157**	150
Balance at 31 December	**1,845**	1,688
Net book value	**378**	535

Over the next 5 years, estimated amortisation is expected to be:
2005: £157 million
2006: £156 million
2007: £11 million
2008: £10 million
2009: £10 million

50 Differences between UK GAAP and US GAAP (continued)

b Disposal of businesses

During 2004, the Lloyds TSB Group disposed of substantially all of its interests in Argentina, Colombia, Guatemala, Honduras and Panama; during 2003 the Lloyds TSB Group disposed of its interest in the National Bank of New Zealand, its operations in France and certain of its interests in Brazil.

Under UK GAAP, upon disposal of a business or undertaking, goodwill written off directly against reserves prior to the implementation of FRS 10 ‘Goodwill and Intangible Assets’, is included in the Group’s share of the net assets of the business or undertaking in the calculation of the profit or loss on disposal.

Under US GAAP, all goodwill is capitalised and, up to 31 December 2001, amortised over its estimated useful life. From 1 January 2002, goodwill is no longer amortised but instead subject to impairment testing. Upon disposal of a business or undertaking, the goodwill is included in the calculation of the profit or loss on disposal. Compared to the treatment under UK GAAP, the effect of this is to increase the profits, or reduce the losses, arising on the sale of those businesses acquired before the implementation of FRS 10.

The difference between the profit on disposal under UK GAAP and that recorded under US GAAP was analysed as follows:

	2004 **£m**	**2003** **£m**
Differences in the net book value of goodwill	**3**	89
Other UK/US GAAP accounting differences	**(8)**	6
Exchange adjustments	**–**	(107)
Adjustment to result on sale of businesses	**(5)**	(12)

These adjustments increased the loss on disposal reported under UK GAAP in 2004 of £15 million to £20 million under US GAAP; the adjustments for 2003 reduced the profit on disposal of £865 million under UK GAAP for that year to £853 million under US GAAP.

The trading results of those businesses sold in 2004 were not significant and they have not been classified as discontinued operations. The trading results classified as discontinued operations in the comparative periods relate to the Lloyds TSB Group’s businesses in New Zealand, Brazil and France which were sold in 2003. For those businesses, summarised financial information, prepared in accordance with US GAAP, was as follows:

	2003 £m	2002 £m
Total revenues, net of interest expense	705	640
Income from discontinued operations	354	311
Profit on sale of businesses	853	–
Provision for income tax	(89)	(81)
	1,118	230

c Pension and other post-retirement costs

The measurement of the US GAAP pension cost is undertaken in accordance with the requirements of SFAS No. 87 and SFAS No. 106. The disclosures reflect the amendments arising from SFAS No. 132 ‘Employers’ Disclosures about Pensions and Other Postretirement Benefits’ (revised 2003).

For the reconciliations below, the Group has applied SFAS No. 87 to the Lloyds TSB Group Pension Schemes No’s 1 and 2 with effect from 31 December 1997 as it was not feasible to apply it as of January 1989, the date specified in the standard. The Scottish Widows pension scheme has been included from 3 March 2000, the date of acquisition.

50 Differences between UK GAAP and US GAAP (continued)

Other post-retirement costs include a liability of £99 million (2003: £87 million) in respect of post-retirement healthcare.

Pension expense

The components of the defined benefit pension expense which arise under US GAAP are estimated as:

	2004 £m	2003 £m	2002 £m
Service cost	**286**	267	256
Interest cost	**730**	670	655
Expected return on plan assets	**(824)**	(797)	(817)
Net amortisation and deferral	**212**	3	(79)
Net pension charge	**404**	143	15
Net charge recognised under UK GAAP	**267**	286	128
US GAAP adjustment	**137**	(143)	(113)

Obligations and funded status

	2004 £m	2003 £m
Change in plan assets		
Plan assets at fair value as at 1 January	**10,608**	9,095
Exchange and other movements	**3**	(65)
Actual return on plan assets	**1,098**	1,838
Employer contributions	**374**	138
Benefits paid	**(425)**	(398)
Plan assets at fair value at 31 December	**11,658**	10,608
Change in projected benefit obligation		
Projected benefit obligation as at 1 January	**13,774**	12,183
Exchange and other movements	**–**	(99)
Service cost	**286**	267
Interest cost	**730**	670
Amendments	**28**	37
Net actuarial loss	**580**	1,114
Benefits paid	**(425)**	(398)
Projected benefit obligation at 31 December	**14,973**	13,774
Funded status	**(3,315)**	(3,166)
Unrecognised net actuarial loss	**5,573**	5,454
Unrecognised prior service cost	**233**	233
Accrued/prepaid	**2,491**	2,521
Accrued benefit cost	**(2,417)**	(2,315)
Intangible asset recognised	**233**	231
Accumulated other comprehensive income	**4,675**	4,605
Net amount recognised	**2,491**	2,521
Accrued benefit cost, net of intangible asset recognised under US GAAP	**(2,184)**	(2,084)
Accrued liability recognised under UK GAAP	**3,187**	3,055
US GAAP adjustment	**1,003**	971

Accumulated benefit obligations

The accumulated benefit obligations for all defined benefit pension schemes were £14,075 million at 31 December 2004 (2003: £12,924 million).

Information for pension plans with an accumulated benefit obligation in excess of plan assets is presented in aggregate below:

	2004 £m	2003 £m
Projected benefit obligation	**14,344**	13,168
Accumulated benefit obligation	**13,588**	12,468
Fair value of plan assets	**11,248**	10,227

50 Differences between UK GAAP and US GAAP (continued)

The additional minimum pension liability arising on these plans of £4,908 million (2003: £4,836 million) has been recognised in accumulated other comprehensive income, net of the related intangible asset of £233 million (2003: £231 million) and deferred taxes of £1,403 million (2003: £1,381 million).

Assumptions

The financial assumptions used to calculate the projected benefit obligation at 31 December 2004 and 2003 are as follows:

	2004 %	2003 %
Discount rate	**5.30**	5.40
Expected rate of salary increases	**4.14**	4.04
Rate of pension increases	**2.60**	2.50

The financial assumptions used to determine net cost for the years ended 31 December 2004, 2003 and 2002 are as follows:

	2004 %	2003 %	2002 %
Discount rate	**5.40**	5.60	6.00
Expected return on assets	**6.60**	6.60	6.60
Expected rate of salary increases	**4.04**	3.83	4.04
Rate of pension increases	**2.50**	2.30	2.50

The overall expected return on assets assumption has been determined with the aim of reflecting the average rate of growth expected on the funds invested. In deriving this return the aim is to use a stable, realistic long-term rate of return. In any year, it is considered whether the rate of return is reasonable having regard to the weighted average of the expected returns from each of the main asset classes adjusted to allow for any difference between the levels of the fair value and market related value of assets.

The expected return for each asset class reflects a combination of historical performance analysis, the forward looking views of the financial markets (as suggested by the yields available) and the views of investment organisations. Consideration is also given to the rate of return expected to be available for reinvestment.

Assets

The assets of the pension schemes are invested primarily in equities and fixed interest securities. In accordance with SFAS No. 87, the excess of the plan assets over the projected benefit obligation at the transition date (1 January 1998) is recognised as a reduction to pension expense on a prospective basis over approximately 15 years, which was the average remaining service period of employees expected to receive benefits under the plans.

The pension schemes' asset allocation at 31 December 2004 and 2003 and the target allocation for 2005 is as follows:

	Fairvalue of plan assets at 31 December 2004 %	Fairvalue of plan assets at 31 December 2003 %	Target allocation 2005 %
Equities	**69.3**	70.3	70.0
Debt securities	**17.1**	20.1	20.0
Property	**8.3**	6.7	8.0
Other	**5.3**	2.9	2.0
	100.0	100.0	100.0

The principal investment objective is to hold suitable assets of appropriate liquidity which will generate income and capital growth to meet, together with new contributions from members and the employer, the cost of current and future benefits which the scheme provides.

Following an asset-liability modelling study conducted in 2002, the trustees of Lloyds TSB Group Pension Schemes No's. 1 and 2 considered the target asset allocation in the table above to be appropriate for the purposes of meeting this long-term objective. In determining this allocation, the trustees had regard to the benefits of diversification, the historical rates of return earned, their expected future returns and the expected short-term volatility of each asset class.

The trustees have taken advice from the Scheme Actuary and investment consultant to ensure that this target allocation is suitable for the schemes given their liability profiles. A number of investment managers have been employed to manage the schemes' assets and each has been given a specific benchmark and performance objective.

The approach taken by the trustees of Lloyds TSB Group Pension Schemes No's. 1 and 2 is similar to that taken by the trustees of the other Lloyds TSB Group pension schemes.

50 Differences between UK GAAP and US GAAP (continued)

Employers' contributions

Employers' contributions were £374 million during 2004 (2003: £138 million). Employers' contributions are expected to be approximately £425 million during 2005.

Employers' benefit payments

Employers' benefit payments were £425 million during 2004 (2003: £398 million). Estimated future benefit payments are

2005	£434 million
2006	£461 million
2007	£489 million
2008	£518 million
2009	£549 million
2010-2014	£3,250 million

d Share compensation schemes

In accordance with SFAS No. 123 the Group accounts for share compensation schemes based on their estimated fair value at the date of grant. The following disclosures only reflect options granted from 1 January 1995 onwards. In the initial phase-in period, the amounts will not be representative of the effect on reported net income for future years. The SFAS No. 123 charge for the fair value of share compensation grants since 1 January 1996 is:

	2004 £m	2003 £m	2002 £m
Balance at 1 January	**(321)**	(208)	(164)
Charge for grants in the year	**(4)**	(17)	(9)
Charge for grants in prior years	**(19)**	(96)	(35)
Total charge for the year	**(23)**	(113)	(44)
Balance at 31 December	**(344)**	(321)	(208)

During the period from 1 January 1995 to 31 December 2004 the Group operated the following stock compensation plans:

Executive share option schemes

The Executive share option schemes are long-term incentive schemes and are available to certain senior executives of the Group, with grants usually made annually. Options are granted within limits set by the rules of the schemes. These limits relate to the number of shares under option and the price payable on the exercise of options. From 18 April 2001, the aggregate value of the award based upon the market price at the date of grant must not exceed four times the executive's annual remuneration and, normally, the limit for the grant of options to an executive in any one year would be equal to 1.5 times annual salary with a maximum performance multiplier of 3.5. Prior to 18 April 2001, the normal limit was equal to one year's remuneration and no performance multiplier was applied.

Options are normally exercisable between three and ten years from the date of grant. However, the exercise of the options is subject to the satisfaction of the following performance conditions:

For options granted after March 2001

The performance condition is linked to the performance of Lloyds TSB Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 17 companies including Lloyds TSB Group plc.

The performance condition is measured over a three year period commencing at the end of the financial year preceding the grant of the option and continuing until the end of the third subsequent year. If the performance condition is not then met, it will be measured at the end of the fourth financial year. If the condition has not then been met, the options will lapse.

To meet the performance conditions, the Group's ranking against the comparator group must be at least ninth. The full grant of options will only become exercisable if the Group is ranked first. A performance multiplier will be applied below this level to calculate the number of shares in respect of which options granted to executive directors will become exercisable, and will be calculated on a sliding scale. If Lloyds TSB Group plc is ranked below median the options will not become exercisable.

Options granted to senior executives other than executive directors are not so highly leveraged and as a result, different performance multipliers are applied to their options. For the majority of executives, options are granted with the performance condition but no performance multiplier.

50 Differences between UK GAAP and US GAAP (continued)

For options granted up to March 2001

Options granted	Performance conditions
Prior to March 1996	None.
March 1996	Growth in earnings per share which is equal to the aggregate percentage change in the Retail Price Index plus two percentage points for each complete year of the relevant period.
March 1997 – August 1999	That Lloyds TSB Group plc's ranking based on total shareholder return (calculated by reference to both dividends and growth in share price) over the relevant period should be in the top fifty companies of the FTSE 100 and that there must have been growth in earnings per share which is equal to the aggregate percentage change in the Retail Price Index plus two percentage points for each complete year of the relevant period.
March 2000 – March 2001	As for March 1997 – August 1999 except that there must have been growth in the earnings per share equal to the change in the Retail Price Index plus three percentage points for each complete year of the relevant period.

In respect of options granted between March 1996 and March 2001, the relevant period for the performance conditions begins at the end of the financial year of the date of grant and will continue until the end of the third financial year following commencement or, if not met, the end of such later year in which the conditions are met. Once the conditions have been satisfied the options will remain exercisable without further conditions. If they are not satisfied by the tenth anniversary of the grant the option will lapse.

The effect of the performance conditions on the value of the executive share options has been determined by assuming that the earnings per share condition will be satisfied at all times and by using a stochastic projection model to determine the effect of the market-based condition. The compensation cost accrued in the US GAAP financial statements has therefore been based on a best estimate of the number of options that are likely to vest. To the extent that actual forfeitures are different from the estimate, the calculation of the compensation cost will be revised as appropriate.

As at 31 December 2004, no options granted under the Executive share scheme have lapsed as a result of a failure to satisfy the performance conditions.

Executive scheme	**2004 Number of options**	**2004 Weighted average exercise price (pence)**	2003 Numberof options	2003 Weighted average exercise price (pence)	2002 Numberof options	2002 Weighted average exercise price (pence)
Outstanding at 1 January	**33,000,905**	**560.18**	20,990,641	670.58	15,153,496	651.07
Granted	**12,998,345**	**418.67**	13,405,502	393.63	6,940,024	711.53
Exercised	**(372,348)**	**278.74**	(57,092)	254.00	(369,721)	420.49
Forfeited	**(6,337,472)**	**560.66**	(1,338,146)	636.51	(733,158)	781.17
Outstanding at 31 December	**39,289,430**	**515.95**	33,000,905	560.18	20,990,641	670.58

The weighted average fair value of options granted in the year was £0.47 (2003: £0.62; 2002: £1.41). Of the options outstanding at 31 December 2004 1,949,426 were exercisable (2003: 6,930,536; 2002: 4,409,916) and had a weighted average exercise price of £6.50 (2003: £6.24; 2002: £6.84).

Lloyds TSB Group Executive Share Plan 2003

The plan was adopted in December 2003 and under the plan share options may be granted to senior employees, who are not directors of Lloyds TSB Group. An option was granted to one employee on 9 March 2004 and two options were granted to a second employee on 14 December 2004; in each case these were granted specifically to facilitate recruitment. The option granted on 9 March 2004 has a total exercise price of £1 and is exercisable in the six month period beginning on 2 January 2007. The two options granted on 14 December 2004 are nil cost options with no exercise price. The option over 56,433 shares is exercisable in the six month period beginning 16 October 2006 and the option over 104,966 shares is exercisable in the six month period beginning 2 December 2007. Options granted under this plan are not subject to any performance conditions.

Lloyds TSB Group Executive Share Plan 2003	**2004 Number of options**	**2004 Weighted average exercise price (pence)**
Outstanding at 1 January	**–**	**–**
Granted during the year	**206,647**	**Nil**
Outstanding at 31 December	**206,647**	**Nil**

The weighted average fair value of options granted in the year was £3.69. No options outstanding at 31 December were exercisable.

50 Differences between UK GAAP and US GAAP (continued)

Share retention plan

In 2001, the Group adopted the Lloyds TSB Group plc Share Retention Plan. Options granted under this scheme are not subject to any performance conditions. The option granted in 2001 was made specifically to facilitate the recruitment of Mr Daniels, has a total exercise price of £1, and is exercisable in the six month period beginning 31 December 2004.

Share retention plan	**2004 Number of shares**
Outstanding at 1 January and 31 December	**216,763**

The weighted average remaining vesting period as at 31 December 2004 was nil; Mr Daniels exercised his option under the plan subsequent to the year end.

Lloyds TSB Group plc Share Plan 2003

In 2003, the Group adopted the Lloyds TSB Group plc Share Plan 2003. Options granted under this scheme were not subject to any performance conditions. An option was granted in 2003 specifically to facilitate the recruitment of Mr Targett, this option had a total exercise price of £1, and would have been exercisable in the six month period beginning 31 December 2005; however this option lapsed during 2004 following Mr Targett’s resignation.

Lloyds TSB Group plc Share Plan 2003	**2004 Number of shares**
Outstanding at 1 January	**331,125**
Lapsed during the year	**(331,125)**
Outstanding at 31 December	**-**

Save-As-You-Earn scheme

Eligible employees may enter into contracts through the Save-As-You-Earn (SAYE) scheme to save up to £250 per month and, at the expiry of a fixed term of three or five years, have the option to use these savings within six months of the expiry of the fixed term to acquire shares in the Group at a discount, which is currently 20 per cent of the market price at the date the options were granted. Grants in periods up to 31 December 2001 also had options exercising after seven years.

	2004 Numberof options	**2004 Weighted average exercise price (pence)**	2003 Numberof options	2003 Weighted average exercise price (pence)	2002 Numberof options	2002 Weighted average exercise price (pence)
SAYE scheme						
Outstanding at 1 January	**124,683,429**	**335.85**	104,548,147	489.55	106,806,493	479.30
Granted	**16,225,108**	**322.90**	100,863,926	289.23	35,113,451	508.28
Exercised	**(1,280,773)**	**354.59**	(4,267,120)	355.14	(18,847,753)	409.39
Forfeited/cancelled	**(17,511,857)**	**421.09**	(76,461,524)	483.43	(18,524,044)	547.53
Outstanding at 31 December	**122,115,907**	**321.71**	124,683,429	335.85	104,548,147	489.55

The weighted average fair value of options granted in the year was £0.92 (2003: £0.85; 2002: £1.75). Of the options outstanding at 31 December 2004 1,308,580 were exercisable (2003: 3,422,122; 2002: 3,923,030) and had a weighted average exercise price of £6.20 (2003: £5.60; 2002 £5.87). In 2004 cancellations of approximately 8 million shares (2003: approximately 56 million; 2002: approximately 14 million) are included in the above amounts.

The Lloyds TSB Group Shareplan (‘Shareplan’)

The Shareplan was established for the purpose of providing an enhanced remuneration package for employees. Lloyds TSB Group shares are provided to employees in three ways:

Free shares: these are awarded to employees for no consideration, as a percentage of salaries by reference to the performance of Lloyds TSB Group. If an employee leaves the Group within three years from the date of award other than for a proscribed reason (such as redundancy, death or retirement after age 50 or due to ill health), a portion of the shares awarded will be forfeited – 75% within one year of the award, 50% within 2 years and 25% within 3 years;

Partnership shares: these are acquired by employees via monthly contributions;

Matching shares: these are additional shares awarded for no consideration to employees acquiring partnership shares. If an employee leaves the Group within three years from the date of award for a reason other than for a proscribed reason (such as redundancy, death or retirement after age 50 or due to ill health) or sells the accompanying partnership shares within the three year period, the matching shares awarded will be forfeited.

The weighted average fair value of shares awarded in the year in respect of free shares was £4.27 (2003: £4.09, the first year of award). The weighted average fair value of shares awarded in the year in respect of matching shares was £4.28 (2003: £4.35, the first year of award).

50 Differences between UK GAAP and US GAAP (continued)

The ranges of exercise prices, weighted average fair values and weighted average contractual life for the options granted under the Lloyds TSB Group Executive Share Plan 2003 ("Executive Share Plan"), Executive and SAYE option schemes outstanding at 31 December 2004, 2003 and 2002 are shown in the table below:

	2004 Executive Share Plan	**2004 Executive**	**2004 SAYE**	2003 Executive	2003 SAYE	2002 Executive	2002 SAYE
Exercise price (pence)	**Nil**	**242.50-887.50**	**284.00-768.00**	242.50-887.50	253.00-768.00	242.50-887.50	160.40-768.00
Fair value (pence)	**369**	**40-209**	**86-295**	62-209	85-295	63-209	67-295
Weighted average remaining life (years)	**2.5**	**7.66**	**2.87**	7.8	3.5	7.7	2.8

The ranges of exercise prices, weighted average exercise prices, weighted average remaining contractual life and number of options outstanding at 31 December 2004 for the Executive and SAYE schemes are as follows:

	Executive Share Plan			**Executive schemes**			**SAYE schemes**		
Exercise price range	**Weighte average exercise price (pence)**	**Weighted average remaining life (years)**	**Number of options**	**Weighte average exercise price (pence)**	**Weighted average remaining life (years)**	**Number of options**	**Weighte average exercise price (pence)**	**Weighted average remaining life (years)**	**Number of options**
£0 to £2	**Nil**	**2.5**	**206,647**	**–**	**–**	**–**	**–**	**–**	**–**
£2 to £3	**–**	**–**	**–**	**245.01**	**0.2**	**127,058**	**284.00**	**3.0**	**83,117,427**
£3 to £4	**–**	**–**	**–**	**392.82**	**8.0**	**10,386,979**	**330.51**	**3.7**	**21,992,866**
£4 to £5	**–**	**–**	**–**	**419.89**	**9.2**	**13,813,324**	**452.21**	**1.4**	**10,674,528**
£5 to £6	**–**	**–**	**–**	**541.65**	**4.6**	**2,767,256**	**554.84**	**1.6**	**5,849,754**
£6 to £7	**–**	**–**	**–**	**665.06**	**6.3**	**3,063,872**	**632.00**	**1.2**	**105,995**
£7 to £8	**–**	**–**	**–**	**717.64**	**7.1**	**7,392,741**	**723.79**	**0.5**	**375,337**
£8 to £9	**–**	**–**	**–**	**873.34**	**3.7**	**1,738,200**	**–**	**–**	**–**

Of the above outstanding options, the following were exercisable as at 31 December 2004:

	Executive Share Plan		**Executive schemes**		**SAYE schemes**	
	Exercisable	**Weighte average exercise price**	**Exercisable**	**Weighte average exercise price**	**Exercisable**	**Weighte average exercise price**
£0 to £2	**–**	**–**	**–**	**–**	**–**	**–**
£2 to £3	**–**	**–**	**127,058**	**245.01**	**–**	**–**
£3 to £4	**–**	**–**	**202,368**	**321.00**	**–**	**–**
£4 to £5	**–**	**–**	**–**	**–**	**8,810**	**416.00**
£5 to £6	**–**	**–**	**678,500**	**510.00**	**961,292**	**585.89**
£6 to £7	**–**	**–**	**–**	**–**	**3,433**	**632.00**
£7 to £8	**–**	**–**	**–**	**–**	**335,045**	**724.42**
£8 to £9	**–**	**–**	**941,500**	**876.52**	**–**	**–**
			1,949,426		**1,308,580**	

The weighted average fair value calculations for options granted during 2004 are based on the following assumptions:

	Executive Share Plan	**Executive schemes**	**SAYE schemes**
Risk-free interest rate	**4.41%**	**4.57%**	**4.79%**
Expected life	**2.6 years**	**5 years**	**3.9 years**
Expected volatility	**30%**	**30%**	**30%**
Expected dividend yield	**7.11%**	**7.5%**	**7.5%**

Details of options outstanding in respect of stock compensation plans operated prior to 1 January 1995 are as follows:

2004	**Numberof options at 31 December**	**Weighted average option price at 31 December (pence)**	**Numberof shares as to which options were exercisable at 31 December**	**Number of options lapsed during year**	**Number of options exercised during year**	**Weighted average exercise price (pence)**
Lloyds TSB Group plc Executive Share Option Scheme	**–**	**–**	**–**	**38,937**	**48,952**	**282.50**
Lloyds Bank plc Senior Executives' UK Share Option Scheme 1987	–	–	–	–	**52,728**	**200.70**
	–	**–**	**–**	**38,937**	**101,680**	

50 Differences between UK GAAP and US GAAP (continued)

2003	Numberof options at 31 December	Weighted average option price at 31 December (pence)	Numberof shares as to which options were exercisable at 31 December	Number of options lapsed during year	Number of options exercised during year	Weighted average exercise price (pence)
Lloyds TSB Group plc Executive Share Option Scheme (1989)	–	–	–	–	48,680	162.50
Lloyds TSB Group plc Executive Share Option Scheme	87,889	282.50	87,889	–	23,008	–
Lloyds Bank Plc Senior Executives’ UK Share Option Scheme 1987	52,728	200.70	52,728	–	35,152	201.60
	140,617		140,617	–	106,840	

e Earnings per share

Basic earnings per share under US GAAP differ from UK GAAP (see note 11) only to the extent that income calculated under US GAAP differs from UK GAAP.

Diluted earnings per share measures the effect that existing share options would have on the basic earnings per share if they were to be exercised, by increasing the number of ordinary shares, although any options that are anti-dilutive are excluded from this calculation. An option is considered anti-dilutive when the value of the exercise price exceeds the market price. Under US GAAP certain incentive plan shares, for which the trustees have waived all dividend and voting rights, have also been included in the calculation of diluted earnings per share.

	2004	2003	2002
Basic			
Net income (US GAAP)	**£ 1,508m**	£ 3,231m	£ 1,753m
Weighted average number of ordinary shares in issue	**5,590m**	5,581m	5,570m
Earnings per share	**27.0p**	57.9p	31.5p
Diluted			
Net income (US GAAP)	**£ 1,508m**	£ 3,231m	£ 1,753m
Weighted average number of ordinary shares in issue	**5,625m**	5,600m	5,600m
Earnings per share	**26.8p**	57.7p	31.3p

The weighted average number of anti-dilutive shares excluded from the calculation of diluted earnings per share was 39 million at 31 December 2004 (2003: 71 million; 2002: 17 million).

f Derivatives

Under UK GAAP, the Group uses a variety of financial instruments to hedge exposures in its banking book; these hedges are accounted for on an accruals basis, in line with the underlying instruments being hedged. Any gains or losses that would arise if these instruments were carried at market value are therefore not recognised.

For the purposes of US GAAP, the Group believes that derivatives that are hedges under UK GAAP do not qualify for hedge accounting under the provisions of SFAS No. 133; prior to the adoption of SFAS No. 133, such exposures did not qualify for hedge accounting under US GAAP either and therefore there was no transition adjustment in respect of SFAS No. 133. Accordingly these exposures have been marked to market, with the resulting gains and losses taken directly to income. In addition, an adjustment to measure embedded derivatives that are not deemed to be clearly and closely related to the underlying host contract at their fair value has been included within unrecognised gains and losses during the year. The movement in the US GAAP adjustment arising is summarised below:

	2004 £m	2003 £m	2002 £m
Balance at 1 January	**76**	(98)	(417)
Exchange and other adjustments	**3**	(10)	14
Net (losses) gains recognised in the year	**(3)**	150	396
Unrecognised (losses) gains arising during the year	**(57)**	22	(91)
	(60)	172	305
Adjustments on disposal of businesses	**–**	12	–
Balance at 31 December	**19**	76	(98)

These activities are discussed more fully on pages 58 to 60 and in note 47 on page F-48.

The application of EITF 02-3 ‘Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities’, which does not allow the recognition of an unrealised gain or loss at the inception of a derivative contract unless the models used to value these contracts use market observable inputs, has not had an impact on Lloyds TSB Group’s US GAAP financial statements. The fair value of these contracts is calculated using quoted prices in an active market or prices where the fair value is determined using a valuation technique that incorporates observable market data.

50 Differences between UK GAAP and US GAAP (continued)

g Investment securities

Under UK GAAP investment securities are held at amortised cost except within the long-term insurance businesses where the securities are held at market value, with unrealised gains and losses taken to the income statement in the period to which they relate.

Under SFAS No. 115 all debt securities and equity shares are classified and disclosed as either held-to-maturity, available-for-sale or trading. Those classified as held-to-maturity are measured at amortised cost. Available-for-sale securities are measured at fair value with unrealised gains and losses excluded from the income statement and reported net of tax and minority interests as a separate component of other comprehensive income. Trading securities are measured at fair value with unrealised gains and losses included in the income statement. Debt securities and equity shares categorised as available-for-sale under US GAAP give rise to an adjustment to accumulated other comprehensive income as detailed on page F-65.

The disclosures for investment securities in the tables below include those held within the banking business as reported in notes 17 and 18, those held within the insurance business and those included as a result of consolidation under the provisions of FIN 46-R (see note l). Securities held by the general insurance business are included within notes 17 and 18 under UK GAAP; for the purposes of US GAAP they are classified within insurance activities. At 31 December 2004, the book and market values of these securities were £386 million (2003: £396 million). The Group had no held-to-maturity securities at 31 December 2004 or 31 December 2003.

	2004 **£m**	2003 £m
Proceeds from sales and maturities of available-for-sale investment debt securities and equity shares	**10,873**	14,448
Gross realised gains	**(155)**	(136)
Gross realised losses	**13**	47
Net amount sold	**10,731**	14,359

Realised gains and losses are computed using the weighted average cost method. No gross gains (2003: £13 million) were recorded on securities transferred from available-for-sale to trading.

2004	Amortised cost £m	Gross unrealised gains £m	Gross unrealised losses £m	Carrying value £m
Available-for-sale investment securities:				
UK government	**775**	**82**	**–**	**857**
Securities of the US treasury and US government agencies	**1,665**	**4**	**(3)**	**1,666**
European governments	**15**	**1**	**–**	**16**
Other government securities	**994**	**22**	**(1)**	**1,015**
Other public sector securities	**106**	**3**	**(1)**	**108**
Bank and building society certificates of deposit	**1,901**	**2**	**(1)**	**1,902**
Corporate debt securities	**6,506**	**211**	**(9)**	**6,708**
Mortgage backed securities	**2,890**	**11**	**–**	**2,901**
Other asset backed securities	**3,826**	**16**	**(14)**	**3,828**
Other debt securities	**887**	**2**	**–**	**889**
Debt securities	**19,565**	**354**	**(29)**	**19,890**
Equity shares	**29**	**25**	**–**	**54**
	19,594	**379**	**(29)**	**19,944**
Of which:				
Banking	**13,731**	**55**	**(19)**	**13,767**
Insurance	**5,863**	**324**	**(10)**	**6,177**
	19,594	**379**	**(29)**	**19,944**

50 Differences between UK GAAP and US GAAP (continued)

2003	Amortised cost £m	Gross unrealised gains £m	Gross unrealised losses £m	Carrying value £m
Available-for-sale investment securities:				
UK government	734	46	(3)	777
Securities of the US treasury and US government agencies	1,624	13	(11)	1,626
European governments	15	1	–	16
Other government securities	807	22	(3)	826
Other public sector securities	75	1	(2)	74
Bank and building society certificates of deposit	2,515	–	–	2,515
Corporate debt securities	5,483	152	(33)	5,602
Mortgage backed securities	2,211	2	(1)	2,212
Other asset backed securities	3,942	12	(3)	3,951
Other debt securities	1,313	3	(1)	1,315
Debt securities	18,719	252	(57)	18,914
Equity shares	35	97	(1)	131
	18,754	349	(58)	19,045
Of which:				
Banking	13,380	133	(24)	13,489
Insurance	5,374	216	(34)	5,556
	18,754	349	(58)	19,045

For those investments on which there is a gross unrealised loss at 31 December 2004, the fair values and analysis by period for which there has been a loss position are as follows:

	Period investment has been in an unrealised loss position					
	Less than one year		Greater than one year		Total	
2004	Unrealised losses £m	Fai value £m	Unrealised losses £m	Fai value £m	Unrealised losses £m	Fai value £m
Securities of the US treasury and US government agencies	**3**	**323**	**–**	**–**	**3**	**323**
Other government securities	**–**	**3**	**1**	**21**	**1**	**24**
Other public sector securities	**–**	**–**	**1**	**17**	**1**	**17**
Bank and building society certificates of deposit	**1**	**1,382**	**–**	**–**	**1**	**1,382**
Corporate debt securities	**1**	**63**	**8**	**329**	**9**	**392**
Other asset backed securities	**–**	**7**	**14**	**395**	**14**	**402**
Total	**5**	**1,778**	**24**	**762**	**29**	**2,540**

At 31 December 2003, the aggregate amount of unrealised losses outstanding for less than 12 months was £40 million, and related to investment securities with a fair value of £651 million; the aggregate amount of unrealised losses outstanding for more than 12 months was £18 million, and related to investment securities with a fair value of £206 million.

The changes in fair value in 2004 and 2003 are primarily caused by movements in interest rates rather than movements in credit ratings. Accordingly, Lloyds TSB Group considers that these unrealised losses are temporary in nature and accordingly no charge has been made for other-than-temporary impairment. The amortised cost includes provisions of £117 million (2003: £105 million) that have been raised under UK GAAP; these provisions are considered as permanent under US GAAP and no further provisions are deemed necessary.

	Due within 1 year £m	Due between 1 and 5 years £m	Due between 5 and 10 years £m	Due over 10 years £m	Nofixed maturity £m	Total £m
Maturity of investment debt securities:						
2004						
Available-for-sale						
Amortised cost	**3,228**	**7,642**	**4,222**	**4,091**	**382**	**19,565**
Fair value	**3,230**	**7,620**	**4,313**	**4,316**	**411**	**19,890**
2003						
Available-for-sale						
Amortised cost	3,011	7,121	4,361	4,078	148	18,719
Fair value	3,010	7,100	4,433	4,216	155	18,914

50 Differences between UK GAAP and US GAAP (continued)

h Own shares related items

Additional own shares held of £154 million at 31 December 2004 (2003: £154 million) have been netted off against Additional Paid-in Capital within Shareholders' equity in accordance with ARB No. 51. This relates to the amount of Lloyds TSB Group plc shares held within the long-term assurance funds that have not been deducted from equity under UK GAAP.

The adjustment to shareholders' funds on page F-64 of £185 million (2003: £195 million) also includes removal of the accrual in respect of free shares. Under UK GAAP such accruals are included within reserves.

i Deferred taxation

In accordance with the provisions of SFAS No. 109, the US GAAP deferred tax liability is:

	2004 £m	2003 £m
Deferred tax liabilities		
Assets used in the business	**38**	10
Assets leased to customers	**1,625**	1,593
Transfers from long-term business fund (see note 9)	**230**	110
Value of business acquired	**374**	496
Deferred acquisition costs	**343**	267
Unrealised gains on investment securities	**20**	–
Pension profit recognition	**42**	50
Other	**229**	263
Total liabilities	**2,901**	2,789
Deferred tax assets		
Goodwill	**(315)**	(315)
Loan loss allowance	**(84)**	(122)
Tax losses:		
– Pensions business	**(1,457)**	(1,353)
– Other	**(459)**	(394)
Specific loan loss allowance	**(10)**	(22)
Pension schemes	**(564)**	(508)
Unrealised losses on trading securities	**–**	(15)
Other	**(508)**	(317)
Total assets	**(3,397)**	(3,046)
Valuation allowance	**1,866**	1,701
US GAAP deferred tax liability	**1,370**	1,444

Valuation allowance

Scottish Widows has a significant with-profits pensions business. This business is subject to UK corporation tax on the basis of a notional return determined by the UK taxation authorities. To the extent that the actual return from the business is less than the notional return, tax losses accumulate which may be carried forward and offset against excess returns in future years. The value of these losses at 31 December 2004 was £1,238 million (2003: £1,140 million). Excess returns do not occur regularly and are only likely to be triggered in the future if interest rates increase significantly or there is significant volatility in the markets or the actuarial valuation basis alters significantly. Given the current low interest rate environment and in view of the fact that the actuarial valuation basis is currently considered unlikely to alter significantly, in the opinion of management it is more likely than not that these losses will not be realised and therefore a full valuation allowance has been established against this balance.

A further valuation allowance of £313 million (2003: £246 million) has been established against other tax losses which are not expected to be utilised in the foreseeable future. Under UK tax legislation, certain capital losses may only be offset against taxable gains of a particular type and consequently the associated deferred tax assets are less certain of realisation.

Assessments have been made as to the likelihood of gains arising that can be offset against these losses and, to the extent that it is more likely than not that these losses will not be realised, appropriate valuation allowances have been established. In relation to other tax losses, the pattern of utilisation of losses over previous years has been reviewed together with gains that may be realised in the foreseeable future and an appropriate valuation allowance established to the extent that it is more likely than not that these losses will not be realised.

A deferred tax asset of £315 million (2003: £315 million) has been recognised as a result of the different accounting and tax treatments for goodwill arising upon acquisition of companies and businesses. There is currently no expectation that these businesses will be disposed of and therefore in the opinion of management it is more likely than not that these losses will not be realised. Accordingly, a full valuation allowance has been established against this balance.

50 Differences between UK GAAP and US GAAP (continued)

Tax losses

The Group has the following tax losses available to be carried forward and offset against the future taxable profits of certain subsidiaries. The majority of the losses may be carried forward indefinitely.

	2004 £m	2003 £m
Trading losses	**1,775**	1,741
Capital losses	**1,408**	1,082
Pensions business	**4,127**	3,800
	7,310	6,623

US GAAP reconciliation

The following tables reconcile the UK GAAP tax charge and deferred tax liability to the US GAAP tax charge and deferred tax liability as disclosed on pages F-66 and F-67.

	2004 £m	2003 £m	2002 £m
UK GAAP Profit and loss tax charge	**1,004**	1,025	766
Deferred tax – US GAAP	**(4)**	(21)	(25)
Deferred tax – US GAAP reconciling items, excluding tax relating to changes in accounting principles*	**(72)**	(83)	(165)
Disposed businesses	**–**	(89)	(81)
US GAAP Profit and loss tax charge for continuing operations	**928**	832	495

*The £74 million UK / US GAAP adjustment shown on page F-64 comprises the above £72 million reduction in the tax charge in respect of continuing operations together with a tax credit of £2 million in respect of the US GAAP adjustments to the loss on disposal of businesses.

	2004 £m	2003 £m
UK GAAP Deferred tax liability	**1,473**	1,376
Deferred tax – UK pension asset	**(956)**	(916)
Deferred tax – US GAAP	**35**	39
Deferred tax - US GAAP reconciling items	**1,031**	1,231
Other items*	**(213)**	(286)
US GAAP Deferred tax liability	**1,370**	1,444

* Under UK GAAP applicable to banking groups, the Group accounts for its life assurance operations using the embedded value basis of accounting and the shareholder's and policyholders' interests are accounted for as one-line items. Under US GAAP the constituent parts of the shareholder's and policyholders' interests are separately disclosed and as a result of this reclassification the total deferred tax liability has been decreased. There is no impact on the underlying shareholder's equity.

j Significant Group concentrations of credit risk

SFAS No. 107 'Disclosure about Fair Value of Financial Instruments' states that concentrations of credit risk exist if a number of counterparties are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. The Group's exposure to credit risk is concentrated in the United Kingdom where the majority of the Group's activities are conducted and is detailed further in note 16.

k Repos, reverse repos and stocklending transactions

The Group enters into reverse repo transactions which are accounted for as collateralised loans. It is the Group's policy to seek collateral which is at least equal to the amount loaned. At 31 December 2004, the fair value of collateral accepted under reverse repo transactions that the Group is permitted by contract or custom to sell or repledge was £12,364 million (2003: £2,077 million). Of this, £3,910 million (2003: £255 million) was sold or repledged as at 31 December 2004. The remainder has been held for continuing use within the business. The Group also enters into repos which are accounted for as secured borrowings. As at 31 December 2004, the carrying value of assets that have been pledged as collateral under repo transactions where the secured party is permitted by contract or custom to sell or repledge was £117 million (2003: £1,714 million). The carrying value of assets that are subject to stocklending arrangements is £373 million all of which the secured party is permitted by contract or custom to sell or repledge.

50 Differences between UK GAAP and US GAAP (continued)

l Variable interest entities

In January 2003, the FASB released FIN 46 ‘Consolidation of Variable Interest Entities’ and subsequently issued a revised version, FIN 46-R, in December 2003. FIN 46-R changes the method of determining whether certain entities should be included in the Group’s consolidated financial statements. An entity is called a variable interest entity (VIE) and is subject to the requirements of FIN 46-R if it has:

- equity that is insufficient to permit the entity to finance its activities without additional subordinated support; or
- equity investors that cannot make significant decisions about the entity’s operations, or that do not have the obligation to absorb the expected losses or the right to receive the expected residual returns of the entity or;
- some equity investors whose obligations to absorb the expected losses or rights to receive the expected residual returns are disproportionate to those voting rights and substantially all of the entity’s activities are conducted on behalf of those equity investors.

A VIE is consolidated by its primary beneficiary, which is the party involved with the VIE that has a majority of the expected losses or a majority of the expected returns or both.

The provisions of FIN 46-R have been applied immediately by Lloyds TSB Group to VIEs created on or after 1 February 2003; for VIEs created before that date, FIN 46-R became effective in 2004. The implementation of FIN 46-R in full has resulted in the consolidation of additional VIEs, which has increased total assets by £4,476 million, reduced shareholders’ equity by £316 million and increased profit before tax and accounting changes by £14 million.

The transition rules contained within FIN 46-R require that if initial application of the requirements of FIN46-R results in initial consolidation of an entity created before 31 December 2003 the difference between the net amount added to the balance sheet and the amount of any previously recognised interest in the newly consolidated entity shall be recognised as the cumulative effect of a change in accounting principle. This has reduced profit before tax by £330 million and profit after tax by £249 million.

The nature of the activities of VIEs in which Lloyds TSB Group has a significant variable interest include:

Financing vehicles

These entities have predominantly pre-determined activities, the nature of which are primarily lending and investments and are undertaken in order to improve the efficiency of Lloyds TSB Group’s normal lending and deposit taking activities. In determining whether to enter into these structures, careful consideration has been given to ensure the structures meet Lloyds TSB Group’s risk management and control requirements.

Leasing partnerships

These relate to limited partnerships which have been created with a third party investor to acquire significant capital items which are then leased out to third parties, typically on an operating lease.

Securitisation conduit vehicles

These vehicles are investment-purchasing companies which purchase asset-backed securities (which are backed by third party assets) from the market and initially from Lloyds TSB Group. These vehicles form part of Lloyds TSB Group’s overall securitisation conduit and are consolidated under UK GAAP as these are considered to be directly controlled by Lloyds TSB Group.

Venture capital enterprises

These relate to medium-sized entities which typically have minimal equity investment, with the bulk of the financing provided by the Group in the form of subordinated lending. Without this lending, the entities would not have sufficient capital to finance their activities.

Open Ended Investment Companies (OEIC’s) and unit trusts

These types of vehicle operate in a similar way except that an OEIC is legally constituted as a limited company. A unit trust fund invests cash pooled from many investors in a wide range of equity shares, corporate bonds or government securities. Each investor has units in the fund proportionate to their cash investment. These units are of equal value and can be freely traded. Their value rises and falls depending on the performance of the underlying investments. The funds are managed by an appointed fund manager.

50 Differences between UK GAAP and US GAAP (continued)

The following table represents the carrying amounts and classification of consolidated assets that are collateral for those VIE operations that are (1) already consolidated under UK and US GAAP which would continue to be consolidated under US GAAP and (2) those VIEs which fall to be consolidated under FIN 46-R:

31 December 2004	Currently consolidated VIEs £m	VIE consolidated under FIN 46-R £m	Total £m
Cash	–	30	30
Tangible fixed assets	1,742	160	1,902
Trading and other investments	–	389	389
Investment securities	3,302	(290)	3,012
Loans	4,936	3,391	8,327
Goodwill	–	175	175
Other assets	130	621	751
Total assets of consolidated VIEs	10,110	4,476	14,586

The total assets of consolidated VIEs is attributable to the following types of vehicles:

31 December 2004	Currently consolidated VIEs £m	VIE consolidated under FIN 46-R £m	Total £m
Financing vehicles	5,107	–	5,107
Leasing partnerships	1,791	–	1,791
Securitisation conduit vehicles	3,212	1,360	4,572
Venture capital enterprises	–	546	546
OEICs and unit trusts	–	2,570	2,570
	10,110	4,476	14,586

The following table shows the total assets and maximum exposure to loss, as at 31 December 2004, for those entities where Lloyds TSB Group has a significant variable interest in a VIE but is not determined to be the primary beneficiary:

	Totalassets £m	Maximu exposure to loss £m
Venture capital enterprises	694	694

Under the transition rules of FIN 46-R, as at 31 December 2003 Lloyds TSB Group was not required to consolidate VIEs created before 1 February 2003. At 31 December 2003, the additional total assets consolidated under FIN 46-R for those VIEs created after 1 February 2003 amounted to £86 million, relating to venture capital enterprises. VIEs that were fully consolidated under UK GAAP which would continue to be consolidated under US GAAP had total assets at 31 December 2003 of £9,191 million.

The FASB continues to provide additional guidance on implementing FIN 46-R through FASB Staff Positions. As this guidance is issued, the Group will continue to review the status of VIEs it is involved with and as a result of any changes in guidance additional VIEs may ultimately be required to be consolidated.

m Guarantees

Lloyds TSB Group utilises a number of different types of lending-related financial instruments, such as commitments and guarantees, to meet the financing needs of its customers. These are discussed more fully in note 46. Most of these guarantees and commitments expire without being drawn. Under the provisions of FIN 45, which establishes accounting and disclosure requirements for guarantors, a liability is required to be recognised for the fair value of guarantees issued from 1 January 2003. The fair value of the obligation is, in the substantial majority of cases, the amount of premium received under the contract. The adoption of FIN 45 did not have a material impact on Lloyds TSB Group’s US GAAP financial statements.

n Trust-preferred securities

The trust-preferred securities that are classified as minority interests under UK GAAP are reclassified as debt in Lloyds TSB Group’s US GAAP financial statements. At 31 December 2004, these amounted to £550 million (2003: £549 million) and further details of these securities can be found in note 39. In the income statement, the amount included in minority interests under UK GAAP of £42 million (2003: £42 million) has been reclassified as interest expense under US GAAP.

o Loan impairment

At 31 December 2004, the Group estimated that there was no difference between the carrying value of its loan portfolio on the basis of SFAS No. 114 and its value in the UK GAAP financial statements. During the year ended 31 December 2004, impaired loans, including those excluded from SFAS No. 114, averaged £1,223 million (2003: £1,424 million).

p Insurance activities

The following tables summarise the adjustments to the profit and loss account and balance sheet which would arise from the application of US GAAP to the Group's insurance businesses.

Profit and loss account	Note	**2004 Life £m**	**2004 General £m**	**2004 Total £m**	2003 Life £m	2003 General £m	2003 Total £m	2002 Life £m	2002 General £m	2002 Total £m
Income from long-term assurance business	i)	(715)	–	(715)	(453)	–	(453)	294	–	294
Other interest and dividends	i)	2,063	–	2,063	1,331	–	1,331	1,187	–	1,187
Insurance premiums	i)	1,317	–	1,317	1,551	–	1,551	1,525	–	1,525
Securities trading and other income	i)	3,033	–	3,033	1,020	–	1,020	(2,101)	–	(2,101)
Policyholder benefits and claims expense	i)	(4,230)	–	(4,230)	(2,814)	–	(2,814)	(1,394)	–	(1,394)
Movement in undistributed policyholder allocations		(789)	–	(789)	118	–	118	1,588	–	1,588
Insurance underwriting, operating and acquisition expenses	i)	(462)		(462)	(676)	2	(674)	(760)	2	(758)
Depreciation	i)	(13)	–	(13)	(15)	–	(15)	(16)	–	(16)
Amortisation of value of long-term assurance business acquired	ii)	(243)	–	(243)	(188)	–	(188)	(725)	–	(725)
Revenue and expense recognition		–	(13)	(13)	(13)	(33)	(46)	–	(3)	(3)
Equalisation provision		–	10	10	–	10	10	–	10	10
Total adjustment before accounting changes		(39)	(3)	(42)	(139)	(21)	(160)	(402)	9	(393)
Cumulative effect of change in accounting principles (gross)		(449)	–	(449)	–	–	–	–	–	–
Total adjustments before tax		(488)	(3)	(491)	(139)	(21)	(160)	(402)	9	(393)

Balance sheet	Note	**2004 Life £m**	**2004 General £m**	**2004 Total £m**	2003 Life £m	2003 General £m	2003 Total £m
Long-term assurance business attributable to the shareholder	iii)	(6,781)	–	(6,781)	(6,481)	–	(6,481)
Long-term assurance assets attributable to policyholders	iii)	(54,764)	–	(54,764)	(50,078)	–	(50,078)
Cash and due from banks		5,877	–	5,877	3,587	–	3,587
Trading and other investments	iv)	42,686	–	42,686	19,052	–	19,052
Investment securities		5,791	–	5,791	5,160	–	5,160
Tangible fixed assets		141	–	141	148	–	148
Deferred acquisition costs	v)	1,152	(25)	1,127	902	(11)	891
Value of long-term assurance business acquired	ii)	1,587	–	1,587	2,094	–	2,094
Separate account assets	viii)	–	–	–	22,494	–	22,494
Other assets		646	–	646	763	–	763
Indebtedness of related parties		2,494	–	2,494	2,200	–	2,200
Long-term assurance liabilities to policyholders	iii)	54,764	–	54,764	50,078	–	50,078
Debt securities in issue		(132)	–	(132)	(256)	–	(256)
Policyholder liabilities	vi)	(51,790)	–	(51,790)	(24,946)	–	(24,946)
Undistributed policyholder allocations	vii)	(1,505)	–	(1,505)	(1,772)	–	(1,772)
Equalisation provision		–	61	61	–	51	51
Other liabilities		(346)	–	(346)	(235)	–	(235)
Separate account liabilities	viii)	–	–	–	(22,494)	–	(22,494)
Indebtedness to related parties		(312)	–	(312)	(322)	–	(322)
Total adjustments before tax		(492)	36	(456)	(106)	40	(66)

Adoption of SOP 03-1

In 2004, Lloyds TSB Group adopted SOP 03-1 'Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts'. Prior to the issue of SOP 03-1, the unit-linked investment contract business of the Group was classified as 'separate account' and was held at fair value. SOP 03-1 sets stringent criteria for the use of 'separate account' classification which UK unit-linked funds are unable to meet. As a consequence, the assets and liabilities previously classified as separate account are now accounted for in the same way as other general account assets (as prescribed by SFAS No. 60) and general account liabilities.

50 Differences between UK GAAP and US GAAP (continued)

Transition rules relating to the implementation of SOP 03-1 require that no prior year adjustments are made and that the opening balance sheet impact is reflected in the current year profit and loss account as a cumulative effect of change in accounting principle. This has reduced profit before tax at 31 December 2004 by £449 million and profit after tax by £305 million. This reduction primarily relates to the effect of carrying the unit-linked investment properties at depreciated cost rather than at fair value and the write-down by £264 million of the value of business acquired as a result of the new Guaranteed Annuity Option reserving requirements.

i) Revenue recognition

Under UK GAAP applicable to banking groups, the Group accounts for its life assurance operations using the embedded value basis of accounting. An embedded value is an actuarially determined estimate of the economic value of a life assurance company, excluding any value which may be attributed to future new business. The embedded value is the sum of the net assets of the life assurance company and the present value of the in-force business. The value of the in-force business is calculated by projecting future net cash flows using appropriate economic and actuarial assumptions and the result discounted at a rate which reflects the shareholders' overall risk premium. The change in the embedded value during any reporting period adjusted for any dividends declared or capital injected, and grossed up at the underlying rate of corporation tax, is reflected in the Group's profit and loss account as income from long-term assurance business.

US GAAP requires that results of the life assurance business should be reported on a gross basis and reflected in appropriate captions in the income statement. Premiums from conventional with-profits policies and other protection-type life insurance policies are recognised as revenue when due from the policyholder. Premiums from unitised with-profits life insurance policies and investment contracts, which have minimal mortality risk, are reported as increases in policyholder account balances when received. Revenues derived from these policies consist of mortality charges, policy administration charges, investment management fees and surrender charges that are deducted from policyholders' accounts and are disclosed within other income.

Under US GAAP, premiums and policy charges received that relate to future periods are deferred until the period to which they relate. For limited payment annuities, the excess of the gross premium over the US GAAP net benefit premium is deferred and amortised in relation to the expected future benefit payments. For investment contracts, policy charges that benefit future periods are deferred and amortised in relation to expected gross profits.

ii) Value of long-term assurance business acquired

Under US GAAP the value of the long-term assurance business acquired ('VOBA') is calculated at acquisition by discounting future earnings to a present value. In subsequent years the VOBA is amortised over the premium recognition period for with-profits life insurance and other protection-type insurance policies using assumptions consistent with those used in computing policyholder benefit provisions. VOBA for investment-type policies and unitised insurance policies is amortised in relation to expected gross profits. Expected gross profits are evaluated regularly against actual experience and revisions made to allow for the effect of any changes.

	2004 **£m**	2003 £m
Balance at 1 January	**2,094**	2,282
Effect of adoption of SOP 03-1	**(264)**	–
Interest accrued on unamortised balance	**158**	255
Amortisation	**(401)**	(443)
Balance at 31 December	**1,587**	2,094

Over the next 5 years the amount of VOBA expected to be amortised prior to interest accruals is:
2005: £132 million
2006: £126 million
2007: £118 million
2008: £109 million
2009: £107 million

iii) Balance sheet

Under UK GAAP applicable to banking groups, in order to reflect the different nature of the shareholder's and policyholders' interests in the long-term assurance business these are shown separately as one-line items in the Group's balance sheet. The value of the long-term assurance business attributable to the shareholder comprises the net assets of the life assurance companies and the value of the in-force business. The assets attributable to policyholders mainly comprise the investments held in the long-term assurance funds either on behalf of policyholders, or which have not yet been allocated to either the policyholders or the shareholder. Liabilities to policyholders mainly comprise policyholder benefit provisions.

Under US GAAP the constituent parts of the shareholder's and policyholders' interests in the long-term assurance business are separately disclosed. Significant differences also arise regarding the valuation of the constituent assets and liabilities, which are discussed further in the notes which follow.

50 Differences between UK GAAP and US GAAP (continued)

iv) Investments

Under UK GAAP applicable to banking groups, debt securities and equity shares held within the long-term assurance funds are included in the Group's balance sheet at market value; investment properties are included at existing use value.

Under US GAAP, debt securities are classified as trading, available-for-sale or held-to-maturity; equity shares may only be classified as trading or available-for-sale. Securities classified as trading are carried at current market value with gains recognised in the income statement. Securities classified as available-for-sale are carried at current market value, and unrealised gains and losses arising are held as a separate component of shareholders' equity. Securities classified as held-to-maturity are carried at amortised cost. In addition, US GAAP requires that all freehold and long leasehold properties should be carried at depreciated historic cost.

For those securities classified as available-for-sale, the disclosures required under SFAS No. 115 are presented in aggregate with the banking business on pages F-80 to F-81.

v) Deferred acquisition costs

Under UK GAAP applicable to banking groups, the cost of acquiring new and renewal life assurance business is recognised in the embedded value calculation as incurred.

Under US GAAP the costs incurred by the Group in the acquisition of new and renewal life insurance business are capitalised. These consist of the acquisition costs, principally commissions, marketing and advertising and the administration costs associated with the processing and policy issuance, typically underwriting. Together these are capitalised as an asset and amortised in relation to the profit margin of the policies acquired.

Deferred acquisition costs for conventional with-profits life insurance and other protection type insurance policies are amortised in relation to premium income using assumptions consistent with those used in computing policyholder benefits provisions. Investment, universal life, and separate account contracts are amortised in proportion to the estimated gross profits arising from the contracts.

vi) Policyholder liabilities

Under UK GAAP applicable to banking groups, future policyholder benefit provisions included in the Group's balance sheet are calculated using either net or gross premium methods for conventional with-profits life insurance and other protection-type policies and are mainly based on fund value amongst other methods for unitised with-profits insurance policies and investment-type policies. Net premiums are calculated using assumptions for interest, mortality, morbidity and expenses. These assumptions are determined as prudent best estimates at the date of valuation.

Under US GAAP, for unitised with-profits insurance and other investment-type policies, the liability is represented by the policyholder's account balance before any applicable surrender charges. Policyholder benefit liabilities for conventional with-profits life insurance and other protection-type insurance policies are developed using the net level premiums method. Assumptions for interest, mortality, morbidity, withdrawals and expenses were prepared using best estimates at date of policy issue (or date of company acquisition by the Group, if later) plus a provision for adverse deviation based on Group experience. Interest assumptions range from 4 per cent to 11 per cent.

vii) Undistributed policyholder allocations

With-profits policies entitle the policyholder to participate in the surplus within the with-profits life fund of the insurance company which issued the policy. Regular bonuses are determined annually by the issuing company's Appointed Actuary and its board of directors. The bonuses that may be declared are highly correlated to the overall performance of the underlying assets and liabilities of the fund in which the contracts participate and are the subject of normal variability and volatility. Terminal bonuses are paid on maturity of the contract and are designed to provide policyholders with a share of the total performance of the issuing company during the period of the contract.

The contract for conventional with-profits business written into the with-profits fund provides that approximately 90 per cent of the surplus arising from the net assets of the fund is allocated to policyholders in the form of annual bonuses. For unitised with-profits business written into the with-profits fund all of the surplus is allocated to policyholders as bonus.

Under UK GAAP all amounts in the with-profits fund not yet allocated to policyholders or shareholders are recorded in the liabilities attributable to policyholders on the Group's balance sheet.

Under US GAAP a liability is established for undistributed policyholder allocations. The excess of assets over liabilities in the with-profits fund is allocated to the policyholders and shareholders in accordance with the proportions prescribed by the contracts. The remaining liability comprises the obligation of the insurance company to the policyholders.

viii) Separate account assets and liabilities

Under UK GAAP, segregated accounts are established for policyholder business for which policyholder benefits are wholly or partly determined by reference to specific investments or to an investment-related index. This is referred to as linked business. Linked business can either be unit-linked, property-linked or index-linked. In the case of the unit-linked and property-linked business the policyholders bear the investment risk. The Group bears the investment risk relating to the index-linked business.

50 Differences between UK GAAP and US GAAP (continued)

In 2004, Lloyds TSB Group adopted SOP 03-1. Prior to the issue of SOP 03-1, the unit-linked investment contract business of the Group was classified as ‘separate account’ and was held at fair value. SOP 03-1 sets stringent criteria for the use of ‘separate account’ classification which UK unit-linked funds are unable to meet. As a consequence, the assets and liabilities previously classified as separate account are now accounted for in the same way as other general account assets (as prescribed by SFAS No. 60) and general account liabilities.

51 Parent company disclosures

a Company profit and loss account

	2004 £m	2003 £m	2002 £m
Net interest income	**20**	24	15
Dividends received from group undertakings	**1,913**	1,911	1,908
Total income	**1,933**	1,935	1,923
Operating expenses	**(46)**	(43)	(39)
Profit on ordinary activities before tax	**1,887**	1,892	1,884
Taxation credit (charge)	**34**	(12)	28
Profit on ordinary activities after tax	**1,921**	1,880	1,912
Dividends	**(1,914)**	(1,911)	(1,908)
Profit (loss) for the year	**7**	(31)	4

b Company balance sheet

	2004 £m	2003 £m
Fixed assets		
Investments		
– Shares in group undertakings	**11,080**	10,753
– Loans to group undertakings	**1,723**	1,723
	12,803	12,476
Current assets		
Debtors falling due within one year		
– Amounts owed by group undertakings	**1,390**	1,387
– Other debtors	**97**	88
Cash balances with group undertakings	**208**	362
	1,695	1,837
Current liabilities		
Amounts falling due within one year		
– Amounts owed to group undertakings	**1,741**	1,913
– Other creditors	**107**	106
– Dividend payable	**1,315**	1,314
	3,163	3,333
Net current liabilities	**(1,468)**	(1,496)
Total assets less current liabilities	**11,335**	10,980
Creditors: amounts falling due after more than one year		
– Loan capital	**1,358**	1,356
Net assets	**9,977**	9,624
Capital and reserves		
Called-up share capital	**1,419**	1,418
Share premium account	**1,145**	1,136
Revaluation reserve	**5,014**	4,687
Profit and loss account	**2,399**	2,383
Shareholders' funds (equity and non-equity*)	**9,977**	9,624

* Shareholders' funds at 31 December 2004 include £100 of non-equity preference share capital issued in the year.

51 Parent company disclosures (continued)

c Company cash flow statement

	2004 £m	2003 £m	2002 £m
Net cash inflow from operating activities	**50**	71	20
Returns on investments and servicing of finance:			
– Dividends received from group undertakings	**1,913**	1,908	1,903
– Interest paid on subordinated liabilities (loan capital)	**(94)**	(96)	(34)
Net cash inflow from returns on investments and servicing of finance	**1,819**	1,812	1,869
Taxation:			
– UK corporation tax (paid) received	**(122)**	119	79
Capital expenditure and financial investment:			
– Capital lending to subsidiaries	**–**	–	(964)
– Disposal of subsidiary undertakings	**1**	–	–
Net cash inflow (outflow) from capital expenditure and financial investment	**1**	–	(964)
Equity dividends paid	**(1,913)**	(1,908)	(1,903)
Net cash (outflow) inflow before financing	**(165)**	94	(899)
Financing:			
Cash proceeds from issue of ordinary share capital and sale of own shares held in respect of employee share schemes	**11**	32	77
– Issue of subordinated liabilities (loan capital)	**–**	–	958
– Repayments of subordinated liabilities (loan capital)	**–**	(14)	–
Net cash inflow from financing	**11**	18	1,035
(Decrease) increase in cash	**(154)**	112	136

d Reconciliation to US GAAP

	2004 £m	2003 £m
Shareholders' funds (UK GAAP)	**9,977**	9,624
Dividends receivable	**(1,314)**	(1,314)
Dividends payable	**1,315**	1,314
Revaluation of shares in group undertakings	**1,480**	2,268
Shareholders' equity (US GAAP)	**11,458**	11,892

e Reconciliation of the movements in shareholders' equity under US GAAP

	2004 £m	2003 £m	2002 £m
Profit after tax (UK GAAP)	**1,921**	1,880	1,912
Dividends receivable	**–**	(3)	(5)
Share compensation schemes	**(35)**	(113)	(44)
Net income (US GAAP)	**1,886**	1,764	1,863
Dividends paid	**(1,913)**	(1,908)	(1,903)
	(27)	(144)	(40)
Issue of shares	**10**	45	77
Movements in relation to own shares	**8**	(6)	5
Share compensation schemes	**35**	113	44
Revaluation of shares in group undertakings	**(460)**	1,694	(3,317)
	(434)	1,702	(3,231)
Shareholders' equity at 1 January	**11,892**	10,190	13,421
Shareholders' equity at 31 December	**11,458**	11,892	10,190

GLOSSARY

Term used	US equivalent or brief description
Accounts	Financial statements.
Associates	Long-term equity investments accounted for by the equity method.
ATM	Automatic Teller Machine.
Attributable profit	Net income.
Broking	Brokerage.
Building society	A building society is a mutual institution set up to lend money to its members for house purchases. See also ‘Demutualisation’.
Called-up share capital	Ordinary shares, issued and fully paid.
Contract hire	Leasing.
Cashpoint	Automatic Teller Machine.
Creditors	Payables.
Dealing	Trading.
Debtors	Receivables.
Demutualisation	Process by which a mutual institution is converted into a public limited company.
Economic profit	See definition under ‘Operating and financial review and prospects – Economic profit’.
Embedded value	See definition under ‘Operating and financial review and prospects – Critical accounting policies’.
Endowment mortgage	An interest-only mortgage to be repaid by the proceeds of an endowment insurance policy which is assigned to the lender providing the mortgage. The sum insured, which is payable on maturity or upon the death of the policyholder, is used to repay the mortgage.
Fees and commissions payable	Fees and commissions expense.
Fees and commissions receivable	Fees and commissions income.
Finance lease	Capital lease.
Freehold	Ownership with absolute rights in perpetuity.
Guaranteed annuity option	See ‘Operating and financial review and prospects – Risk management – Market risk exposures in the insurance businesses’.
Hire purchase	See ‘Description of business – Business and activities – Wholesale and International Banking – Asset finance’.
Interchange	System allowing customers of different Automatic Teller Machine (ATM) operators to use any ATM that is part of the system.
Interest payable	Interest expense.
Interest receivable	Interest income.
ISA	Individual Savings Account.
Leasehold	Land or property which is rented from the owner for a specified term under a lease. At the expiry of the term the land or property reverts back to the owner.
Lien	Under UK law, a right to retain possession pending payment.
Life assurance	Life insurance.
Loan capital	Long-term debt.
Members	Shareholders.
Memorandum and articles of association	Articles and bylaws.
National Insurance	A form of taxation payable in the UK by employees, employers and the self-employed, used to fund benefits at the national level including state pensions, medical benefits through the National Health Service (NHS), unemployment and maternity. It is part of the UK’s national social security system and ultimately controlled by HM Revenue & Customs.
Nominal value	Par value.
One-off	Non-recurring.
Ordinary shares	Common stock.
Overdraft	A line of credit, contractually repayable on demand unless a fixed-term has been agreed, established through a customer’s current account.
Premises	Real estate.
Profit and loss account	Income statement.
Profit and loss account reserve	Retained earnings.
Provisions	Reserves.
Regular premium	Premiums which are payable throughout the duration of a policy or for some shorter fixed period.
Reinsurance	The insuring again by an insurer of the whole or part of a risk that it has already insured with another insurer called a reinsurer.
Share capital	Capital stock.

Term used	US equivalent or brief description
Shareholders’ funds	Stockholders’ equity.
Share premium account	Additional paid-in capital.
Shares in issue	Shares outstanding.
Single premium	A premium in relation to an insurance policy payable once at the commencement of the policy.
Tangible fixed assets	Property and equipment.
Undistributable reserves	Restricted surplus.
Unit trust	Mutual fund.
VaR	Value at Risk, see definition under ‘Operating and financial review and prospects – Risk management – Market risk – Trading exposures from banking activities’.
Weighted sales	The sum of regular premiums plus one-tenth of single premiums paid by customers on life insurance, pensions and unit trusts.
With-profits sub-fund	See ‘Business – Business and activities of Lloyds TSB Group – Insurance and Investments – Life assurance, pensions and investments’.