Growing our business

Lloyds TSB Group

ANNUAL REPORT & ACCOUNTS **2001**

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our governing objective is to maximise shareholder value over time

To meet our governing objective we aim:

- To be a leader in our chosen markets
- To be the first choice for our 16 million customers
- To reduce day-to-day operating costs through increased effectiveness

profit before tax by main businesses

	2001 £ million	2000* £ million
UK Retail Banking	**633**	776
Mortgages	**955**	889
Insurance and Investments	**1,601**	1,425
UK Retail Financial Services	**3,189**	3,090
Wholesale Markets	**937**	746
International Banking	**444**	477
Central group items	**(108)**	(118)
Business as usual operating profit	**4,462**	4,195
Short-term fluctuations in investment returns	**(648)**	(94)
Exceptional restructuring costs	**(217)**	(188)
Abbey National offer costs	**(16)**	–
Profit on sale of Lloyds TSB Asset Management S.A.	**39**	–
Pension provisions	**(70)**	(100)
Changes in economic assumptions	**–**	127
Stakeholder pension related charge	**–**	(80)
Statutory profit before tax	**3,550**	3,860

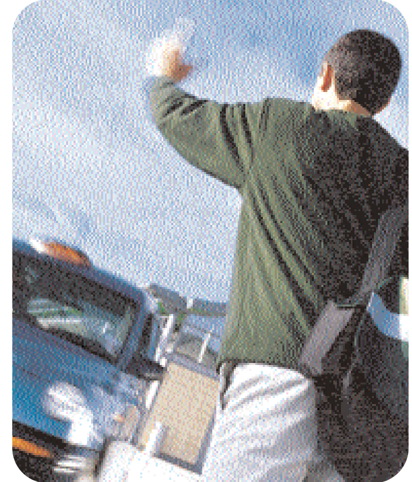
** restated for the effect of FRS 18 (page 61, note 1)*

presentation of results

In accordance with generally accepted accounting practice amongst listed insurance companies in the UK, the results of the Group's life and pensions business have been separately analysed between an operating profit, which includes investment earnings calculated using longer-term investment rates of return, and a profit before tax, separately identifying the short-term fluctuations in investment returns (page 32).

In addition there were other items affecting the Group's 2001 results when compared to 2000. During 2001 there were exceptional restructuring costs in support of the Group's extensive efficiency programme (page 28), acquisition costs relating to the proposed acquisition of Abbey National (page 31), a profit on the sale of Lloyds TSB Asset Management S.A. (page 32), and the impact of a provision for redress to past purchasers of pension policies ('pension provisions'). During 2000 changes in the economic assumptions applied to our long-term assurance business (page 33) and a one-off charge relating to stakeholder pensions (page 33) were also significant. To facilitate comparisons of the results, certain financial information and commentaries have been presented on a 'business as usual operating profit' basis, which excludes the effect of these exceptional items.

Growing our business...



highlights

results

business as usual basis

Total revenue
increased by 10 per cent to £9,544 million.

UK Retail Financial Services
profit up £99 million, or 3 per cent, to £3,189 million.

Operating profit
up 6 per cent to £4,462 million from £4,195 million.

Efficiency ratio
improved to 42.9 per cent compared with 43.4 per cent in 2000.

Profit attributable to shareholders
increased by 8 per cent to £3,188 million.

Earnings per share
increased by 7 per cent to 57.6p.

Economic profit
increased by 6 per cent to £2,204 million.

Post-tax return on average shareholders' equity
29.1 per cent.

other significant achievements during the year include:

During 2001, the Group sold more products to more people than in any previous year.

Customer lending grew by 7 per cent to £123 billion and customer deposits increased by 7 per cent to £109 billion.

On a proforma weighted sales basis, new business premiums in the life and pensions business increased by 31 per cent.

The Group has 1.8 million internet banking customers and *LloydsTSB.com* is one of the most visited financial services websites in Europe.

The Group has improved market share in many key product areas.

statutory basis

Profit before tax
decreased 8 per cent to £3,550 million from £3,860 million. If short-term fluctuations in investment returns were excluded, statutory profit before tax would have increased by 6 per cent to £4,198 million from £3,954 million in 2000.

Earnings per share
decreased by 8 per cent to 45.2p.

Total capital ratio
9.2 per cent, tier 1 capital ratio 8.4 per cent.

Final dividend
of 23.5p per share, making a total of 33.7p for the year, an increase of 10 per cent.

dividends per share (pence)

through investment...

shareholder value

During the year our share price rose by 5 per cent, outperforming both the FTSE All-Share index and the FTSE bank sector index. We have increased the dividend by 10 per cent.

Taking share price appreciation and dividend income together, the total return to shareholders was 10.1 per cent.

chairman's **statement**

Maarten van den Bergh

In my first year as Chairman of Lloyds TSB I am pleased to be able to report that the Group has performed well, particularly against the weakening economic backdrop in the UK and other global economies and the impact on our business of lower stockmarkets.

For the world as a whole, 2001 was particularly challenging. The tragic events of September 11 further enhanced the recessionary tendencies that were clearly becoming visible in many OECD economies, after a prolonged period of continued economic growth. Concerted and significant action by Governments and monetary authorities has, however, provided confidence that signs of an economic rebound should become visible in the second half of 2002.

In the UK, the combination of lower interest rates and continued increases in consumer spending, aided by a further rise in house prices, has underpinned the domestic economy. While there is some concern about the viability of continued consumer spending, a recovery in other world economies should help to keep growth in the UK economy at acceptable, albeit lower, levels in 2002.

our results

The Group's results for 2001 were satisfactory with business as usual operating profit up by 6 per cent to £4,462 million, in part building on the various investments we have made to grow our businesses. On a statutory basis, however, after taking into account a number of special items including negative short-term fluctuations in investment returns of £648 million, profit before tax for the year fell by 8 per cent to £3,550 million. We are under no illusion that we will need to continue to do well to achieve our shareholder value objectives and in so doing underpin our governing objective of maximising value for shareholders over time.

our strategic aims

To support this objective our three strategic aims are clear: to be a leader in our chosen markets; to be first choice for our customers; and to drive down our day-to-day operating costs. This takes energy and it takes creativity; values which Lloyds TSB has in abundance.

We are the UK's number one retail bank with the largest branch network in the UK and one of the largest telephone banking and internet banking operations in Europe. Through Cheltenham & Gloucester, we are one of the largest mortgage lenders in the UK with some £56 billion of mortgages on our balance sheet. Lloyds TSB is also a market leader in the provision of insurance and investment products through Scottish Widows, our specialist provider of life assurance, pensions and long-term

in service...

customer focus

During 2001 we sold more products to more people than ever before.

Our vision for Lloyds TSB remains constant – to create value for our customers. In creating such value for our customers we are able to create, and maximise, value for our shareholders.

savings and investment products. In all of these areas we are well positioned for further income growth.

Whilst income generation is critical to our success, so is cost management. Our focus on maintaining and improving our efficiency has continued unabated and, as a consequence, we expect that our business as usual costs will grow at a slower rate than business as usual revenues, over the next few years.

We are also seeking to grow the Group through acquisitions that complement our good organic strategies, and help provide new opportunities for profitable growth.

We were naturally disappointed by the decision of the Secretary of State to block our proposed acquisition of Abbey National. We did not agree with the decision as competition in financial services has never been more fierce. We were absolutely right to pursue Abbey National when they put themselves in play as the transaction would have delivered additional value for shareholders and integrating companies is something we do very well.

We have made no secret of our desire to achieve an overseas deal. We have talked with our counterparts from many financial services companies, particularly in Europe and the US, and there is no doubt that Lloyds TSB is highly regarded for its considerable selling skills, its cost management and its ability to manage change effectively. We have a great deal we can contribute to any cross-border merger or acquisition, and we do expect that potential opportunities will arise in due course as consolidation throughout Europe accelerates. However, we remain very clear that any such deal will have to add value for our shareholders.

our people

I have been tremendously impressed by the dedication and professionalism of the staff I have met during the year. It is the staff and the management of Lloyds TSB who continue to deliver the company's success and I thank them most warmly for their continued hard work and great effort.

During the year, we were pleased to welcome DeAnne Julius as a non-executive director and Eric Daniels as Group Executive Director, UK Retail Banking, and we look forward to April 2002, when Gavin Gemmell will become a non-executive director and chairman of our Scottish Widows subsidiary.

Dennis Holt left at the end of August, and Lawrence Urquhart will retire from the board and as chairman of Scottish Widows at the annual general meeting. We greatly appreciate the contribution they have made to the Group.

Sir Brian Pitman, my predecessor as Chairman, retired in April and tribute was paid to him in last year's report for his unique contribution to the Lloyds TSB Group and British banking. I have pleasure in reiterating our special thanks for the significant part he played in this organisation's development.

our future

The Lloyds TSB Group is in good shape. We have a number of very strong divisions, all of which are substantial businesses in their own right and which continue to make a very significant contribution to the Group's overall earnings. We have developed the building blocks on which to grow our business and, notwithstanding the economic slowdown, continuing stockmarket volatility and the very competitive environment likely to be experienced in the UK in 2002, we are confident that we will continue to maximise value for our shareholders.

Maarten van den Bergh
Chairman
14 February 2002

distribution...

multi-channel distribution

- 16 million customers
- largest branch network in the UK
- one of the largest telephone banking operations in Europe
- *LloydsTSB.com* is one of the most visited financial websites in Europe

group chief executive's **review**

Peter Ellwood CBE

The clear focus of Lloyds TSB is on meeting our future vision; with total clarity of direction. Whilst we have a very successful track record of performance, the past is the past and it holds little interest for us.

The success of the Lloyds TSB Group in recent years has been undoubted. The combination of the skill, dedication and hard work of our 80,000 staff around the world, a large and discerning customer base, and some of the best brands in the financial services industry, together with our total focus on maximising value for shareholders, has helped to create an organisation valued at over £41 billion at the end of 2001, over three times more than our Group was worth just before the Lloyds TSB merger was announced in 1995.

However, that is history. It has no relevance except as an indicator that a proven track record will help us to deliver in the future. Our vision of the future is about a business which understands and meets the needs of our customers better and more effectively than any of our competitors. It is a vision of a business which creates value for all our customers, thus encouraging them to give us the privilege of looking after more of their business. If we continue to create value for the customer the natural outcome will be to maximise value for our shareholders, and the scope for growth remains substantial.

The Lloyds TSB Group benefits by having a total clarity of strategy. Our governing objective is to maximise shareholder value over time and the three strategic aims by which we have managed our business over recent years remain as relevant today as they have ever been.

First, we need to be a leader in our chosen markets; second, we need to be first choice for our customers by understanding and meeting their needs better than any of our competitors and, third, we need to drive down our day-to-day costs to improve our efficiency and to enable us to continue to invest for future growth. In addition, as we operate increasingly in a global market place, we need to be world class in three vital areas: in customer relationship management, in the way we manage and lead our people, and in the way we manage change which is now an endemic and permanent part of business life.

Considerable progress has been made in the last 12 months to meet our strategic aims and world class aspirations.

a leader in our chosen markets

We strengthened our position in the life and pensions market following the acquisition of Scottish Widows and we are seeing a growth in

customer relationship management

Our CRM systems are beginning to generate substantially more sales leads than ever before and our in-branch information systems have materially enhanced the ability of our staff to identify individual customers' needs and to fulfil those needs.

During 2001, retail banking product sales increased by 14 per cent.

market share in what has been a troubled market in 2001. The acquisition of Chartered Trust has also given us market leadership in the asset finance business. We are now close to our overall objective of being in the top three in every market and business in which we operate. There is clear evidence that market leaders enjoy higher returns than other players.

first choice for our customers

We have made good progress in many areas by focusing on improving our service to customers. During 2001 we completed the implementation of a new online real-time personal banking system which has cost us £250 million over the last three years. Over the next 12-18 months we will complete the process of moving all correspondence and telephone calls out of branches to specialist service centres thus enabling staff in branches to do what they do best – to serve customers face-to-face. We have set ourselves a goal of raising customer service to record levels by the end of 2002, partly by increasing the number of customer facing staff, and to be demonstrably better than our major competitors by the end of 2003. We are totally committed to achieving that objective.

We recruited a record number of new customers during the year, our cross-selling rates are better than any of our peers and the level of customer attrition remains well below the industry average. We have continued to improve our product range and in 2001 the number of customers who chose to pay for their added value current accounts increased to over 3 million. Our successful segmentation strategies have been developed more fully in our retail, business banking and middle market corporate businesses. We have increased the average number of products our customers hold with us to 2.4 products per customer against an industry average today of some 1.9.

driving down our day-to-day costs

We have continued to demonstrate our ability in this area by restricting cost growth to a lower level than income growth and by seeing absolute costs in the second half of 2001 at a lower level than in the first half of the year. In 2002 we will continue with our aim to drive down day-to-day costs and to help achieve this objective we are expanding our efficiency programme, with the objective of keeping 2002 business as usual cost growth to no more than the rate of inflation.

We have made good progress with our three strategic aims and we have also made progress with our three world class aspirations where we are seen as being world class in many aspects of customer relationship management; managing and leading our people; and managing change. The exciting thing about the future is the very real opportunity to excel even more in all these areas as we continue to grow our business.

So, how did our actions flow through into the figures for 2001?

Against a background of significant turbulence and uncertainty in global economies and stockmarkets, the Group has continued to perform well. On a business as usual basis, income rose by 10 per cent and operating profit increased by 6 per cent, with the trading profit before bad debts increasing by 11 per cent. Customer lending increased by 7 per cent, customer deposits increased by 7 per cent and the Group's efficiency ratio improved to 42.9 per cent. Our return on equity was 29.1 per cent and return on assets 1.84 per cent. Our statutory profits fell, but this was after adverse investment fluctuations

products.

products

We have continued to improve our product range to one that is more innovative and attractive than it has ever been. We are the clear market leader in fee based added value accounts. During 2001, we recruited a record number of new current account customers and levels of customer attrition remain low, and well below the industry average.

following the substantial fall in the FTSE All-Share index. If these short-term investment fluctuations were excluded, our statutory profits would have increased by 6 per cent.

This good performance has been achieved against a background of significant change both internally and externally. Internally, the change and investment programmes in retail banking in particular have led to a lower retail banking profit figure in 2001, but with these programmes now largely behind us we are confident of robust profit growth in 2002. Our provisions were heavily influenced by an increase of £100 million in support of our exposure to the ongoing difficulties in Argentina, which we have taken as a prudent and precautionary measure. Asset quality remains good, our total non-performing debt is at similar levels to that seen last year and we remain well positioned to combat any potential downturn in the economy.

performance

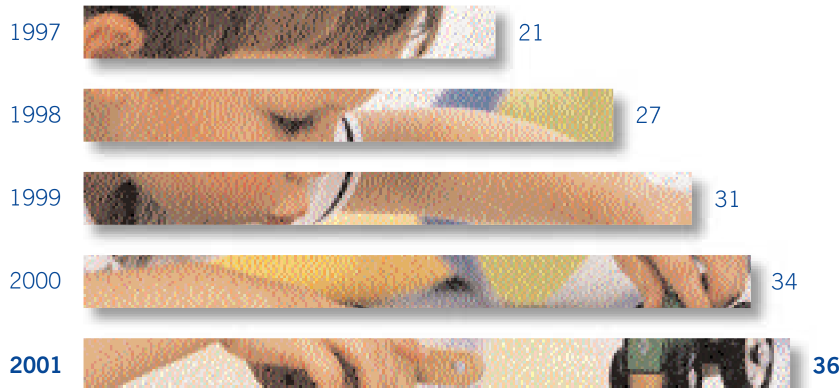
The Group's performance over the last few years can only be described as a modern day success story. Business as usual profit has broadly doubled over the last five years. We have one of the highest returns on equity in the world. We are the only major shareholder owned bank in the world with a 'triple A' rating from Moody's.

We announced at the end of January how Scottish Widows will in future deal with guaranteed annuity rate policies following the *Equitable Life vs Hyman* judgement. When we acquired Scottish Widows in March 2000, an Additional Account was set up within the With Profits Fund. This Account had a value, at 31 December 2001, of approximately £1.7 billion and is available to meet any additional costs of providing guaranteed benefits on transferred policies, including guaranteed annuity option policies. We expect that the Additional Account will be sufficient to meet this cost, as well as other contingencies. This action, which helps to protect both policyholders and shareholders, continues to demonstrate the prudence and strength of the Group.

Going forward, we have no shred of complacency. Our restless pursuit of perfection means we are cognisant of the challenges facing us – of the need to grow short-term profits whilst continuing to invest for the future; of the need to continue to develop our people and to get ever closer to understanding and meeting the needs of our customers; and of the need to maintain asset quality, grow quality income and optimally manage our costs. The organic opportunities for continued robust growth in the Group are very real, and we go forward with confidence to turn those opportunities into reality.

Peter Ellwood CBE
Group Chief Executive
14 February 2002

distribution to the Lloyds TSB Foundations (£m)



our community

As one of the UK's leading companies, Lloyds TSB believes that business success should go hand-in-hand with social responsibility.

That is why we have the largest community investment programme in the UK.

This year the four independent Lloyds TSB Foundations will receive £36 million to distribute to grassroots charities which help disadvantaged and disabled people to play a fuller role in their communities. The Foundations are among the UK's largest general grant-making trusts, and receive one per cent of the Group's pre-tax profits, averaged over three years, in lieu of their shareholder dividend.

And, of course, many of our staff invest their own time in the community – sitting on committees, helping actively or raising money. In 2002, the Foundations will make £1.2 million available to match funds raised, and time given, by staff to charities through the Matched Giving Scheme.

Many of our staff are parents and see education as crucial to their children's development. To reflect this, we have made education a key focus of our community involvement. We support school management in their efforts to raise standards through Quality in Education, a self-assessment and improvement programme using the EFQM Excellence Model. Working in partnership with local education authorities, local learning and skills councils and professional teacher associations, we have introduced Quality in Education to nearly 4,000 schools so far. And the programme carries the active endorsement of both the Department for Education and Skills and the Cabinet Office.

Learning also continues in the workplace and investing in our employees is equally important. The University for Lloyds TSB embodies our commitment to career-long learning and continuous development and we have shared our expertise through sponsorship of the Goodison Group which is recommending priorities to the government in the field of lifelong learning.

In addition to our education programme, we also want to improve the condition of local communities because healthy communities mean healthy business. Lloyds TSB's programme of regeneration initiatives aims to foster economic and social regeneration by creating access to finance for people in disadvantaged communities, backing for small business and by encouraging entrepreneurship.

In 2001, Lloyds TSB won two Department of Trade and Industry sponsored Business in the Community awards for our role in developing the Portsmouth Area Regeneration Trust. This groundbreaking model of a community-based financial institution tackles the effects of financial exclusion and provides disadvantaged people with the first step into mainstream financial services. The initiative is so successful that it is now being replicated across the country in both urban and rural locations.

the businesses of **Lloyds TSB**

Lloyds TSB is one of the leading UK-based financial services groups, whose businesses provide a comprehensive range of banking and financial services in the UK and overseas. At the end of 2001 total group assets were £237 billion and there were over 81,000 employees. Market capitalisation was £41.5 billion.

The main businesses and activities of the Group during 2001 are described below:

UK Retail Financial Services

UK Retail Financial Services encompasses three of the main businesses – UK Retail Banking, Mortgages, and Insurance and Investments – and provides a full range of banking and financial services to 16 million customers.
With more than 2,300 branches of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester (C&G), the Group provides comprehensive geographic coverage in England, Scotland and Wales.

UK Retail Banking

• *Current accounts, savings and investment accounts, and consumer lending.* The retail branches of Lloyds TSB Bank offer a broad range of branded products and C&G provides retail investments through its branch network and a postal investment centre.

• *Card Services* provides a range of card-based products and services, including credit and debit cards and card transaction processing services for retailers. The Group is a member of both the VISA and MasterCard payment systems and is the third largest credit card issuer in the UK.

• *Cash machines.* The Group has one of the largest cash machine networks of any leading banking group in the UK and personal customers of Lloyds TSB Bank are able to withdraw cash, check balances and obtain mini statements through 4,350 cashpoints at branches and external locations around the country. In addition, they have access to a further 32,400 cash machines via LINK in the UK and to cash machines worldwide through the VISA and MasterCard networks.

• *Telephone Banking.* Telephone Banking continues to grow and the Group provides one of the largest telephony services in Europe. At the end of 2001 2.5 million customers had registered to use the services of PhoneBank and the automated voice response service PhoneBank Express.

• *Internet Banking.* Internet Banking provides online banking facilities for personal and business customers and enables them to conduct their financial affairs without using the branch network. Over 1.8 million customers have registered to use the Group's internet banking services.

• *Business Banking.* Small businesses are served by dedicated business managers based in 448 locations throughout the UK. Customers have access to a wide range of tailored business services ranging from traditional banking products through factoring, insurance and investments to non-financial solutions to their business problems such as Debtor Management service providing legal support to help customers recover debts and Prospect Finder providing customers with a tailored list of potential customers for their business. Lloyds TSB is the leading bank for new business start-ups with around one in five opening accounts with the Group.

• *UK Wealth Management.* Private Banking provides a range of tailor-made wealth management services and products to individuals from 40 offices throughout the UK. In addition to asset management, these include tax and estate planning, executor and trustee services, deposit taking and lending, insurance, and personal equity plan and ISA products. At the end of 2001, client funds under management totalled some £11 billion.

Lloyds TSB Stockbrokers undertakes retail stockbroking through its Sharedeal Direct telephone service.

Mortgages

Cheltenham & Gloucester is the Group's specialist residential mortgage provider, selling its mortgages through branches of C&G and Lloyds TSB Bank in England and Wales, as well as through the telephone, internet and postal service, C&G TeleDirect. The Group is the third largest residential mortgage lender in the UK, with a market share of 9.5 per cent, loans outstanding at the end of 2001 of £56.6 billion and over 985,000 borrowers.

Insurance and Investments

• *Scottish Widows* is the Group's specialist provider of life assurance, pensions and investment products, which are distributed through the Lloyds TSB branch network, through independent financial advisers and directly via the telephone and the internet.

• *General insurance.* Lloyds TSB General Insurance provides general insurance and broking services through the retail branches of Lloyds TSB Bank and C&G, and through a direct telephone operation and the internet. The business is the market leader in the distribution of household insurance in the UK.

• *Scottish Widows Investment Partnership* manages funds for the Group's retail life, pensions and investment products. Clients also include corporate pension schemes, local authorities and other institutions in the UK and overseas. At the end of 2001 funds under management totalled some £78 billion.

Wholesale Markets

The Group's relationships with major UK and multinational companies, banks and institutions, and medium-sized UK businesses, together with its activities in financial markets, are managed through dedicated offices in the UK and a number of locations overseas, including New York.

• *Treasury* is a leading participant in the Sterling money market. It is active in currency money markets, foreign exchange markets and also in certain derivatives markets to meet the needs of customers, and as part of the Group's trading activities, including liquidity management.

• *Corporate and Commercial* provides a wide range of banking and related services, including electronic banking, large value lease finance, share registration, venture capital, correspondent banking and capital markets services to major UK and multinational companies, financial institutions and, through a network of dedicated offices, to medium-sized businesses in the UK. The Agricultural Mortgage Corporation provides long-term finance for the agricultural sector.

• *Asset Finance* provides leasing, hire purchase and loan products to the corporate and personal sectors. Lloyds TSB Commercial Finance and Alex Lawrie Factors are leading invoice discounting and factoring companies, providing working capital finance to developing companies.

International Banking

• *The Americas.* The Group has operated in The Americas for over 130 years and has offices in Brazil, Argentina, Colombia and 6 other countries. In addition there are private banking and investment operations in the United States and the Bahamas.

• *New Zealand.* The National Bank of New Zealand is the country's second largest bank and provides a full range of banking services through some 159 outlets.

• *Europe.* International Wealth Management covers services to wealthy individuals outside their country of residence. The business is conducted through Switzerland and through four other countries overseas. There are additional private and corporate banking operations in Spain and France.

• *Offshore Banking* comprises all the Group's offices in the Channel Islands and Isle of Man, as well as its operations in Hong Kong, Singapore and Malaysia and representation in Belgium, Dubai and in the USA. It provides a full range of retail banking, private banking and financial services to overseas residents and islanders, together with deposit services offshore for UK residents.

financial **review**

accounting policies and presentation

Accounting policies are set out on pages 61 to 63. During the year, the Group implemented the requirements of Financial Reporting Standard 18 'Accounting Policies' (FRS 18). On implementation of this new standard, the Group has taken the opportunity to review the appropriateness of accounting policies in a number of areas and the following change has been made as a result. Debt securities acquired in exchange for advances to countries experiencing payment difficulties which are not (nor due to be) collateralised by US Treasury securities ('uncollateralised bonds') were, like the original debt, previously included in loans and advances, at their written down value at date of exchange as adjusted for any subsequent movements in bad debt provisions. This treatment is no longer considered to be the most appropriate and the uncollateralised bonds have been reclassified as debt securities where they are carried at an amount based on the market value at the date of the original exchange as adjusted for the amortisation of the discount on acquisition. A prior year adjustment, increasing reserves by £248 million, has been made to reflect the revised policy.

The effect of this change on the profit and loss account for 2001 has been to increase other operating income by £77 million, increase the charge for bad and doubtful debts by £84 million, increase amounts written off fixed asset investments by £38 million, and to reduce profit before tax by £45 million. Loans and advances have been reduced by £294 million, debt securities have increased by £657 million and shareholders' funds have increased by £254 million. 2000 comparatives have been restated; other operating income increased by £58 million, amounts written off fixed asset investments increased by £18 million and the charge for bad and doubtful debts increased by £66 million. Profit before tax has been reduced, therefore, by £26 million.

In accordance with generally accepted accounting practice amongst listed insurance companies in the UK, the results of the Group's life and pensions business have been separately analysed between an operating profit, which includes investment earnings calculated using longer-term investment rates of return, and a profit before tax, separately identifying the short-term fluctuations in investment returns (page 32).

In addition there were other items affecting the Group's 2001 results when compared to 2000. During 2001 there were exceptional restructuring costs in support of the Group's extensive efficiency programme (page 28), acquisition costs relating to the proposed acquisition of Abbey National (page 31), a profit on the sale of Lloyds TSB Asset Management S.A. (page 32), and the impact of a provision for redress to past purchasers of pension policies ('pension provision'). During 2000 changes in the economic assumptions applied to our long-term assurance business (page 33) and a one-off charge relating to stakeholder pensions (page 33) were also significant. To facilitate comparisons of the results, certain financial information and commentaries have been presented on a 'business as usual operating profit' basis, which excludes the effect of these exceptional items.

forward looking statements

This document contains forward looking statements with respect to the business, strategy and plans of the Lloyds TSB Group, its current goals and expectations relating to its future financial condition and performance. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. Lloyds TSB Group's actual future results may differ materially from the results expressed or implied in these forward looking statements as a result of a variety of factors, including UK domestic and global economic and business conditions, risks concerning borrower credit quality, market related risks such as interest rate risk and exchange rate risk in its banking business and equity risk in its insurance businesses, changing demographic trends, unexpected changes to regulation or regulatory actions, changes in customer preferences, competition and other factors. Please refer to the Registration Statement on Form 20-F of Lloyds TSB Group filed with the US Securities and Exchange Commission for a discussion of such factors.

summary of group results

The Group's business as usual operating profit rose by £267 million, or 6 per cent, to £4,462 million from £4,195 million in 2000, a good performance against a weakening economic backdrop in the UK and other global economies, particularly in Argentina, and the impact on our business of lower stockmarkets. Total income on a business as usual basis increased by 10 per cent and even after allowing for the acquisition of businesses last year, the underlying growth in income was a very satisfactory 7 per cent. Total costs increased by 9 per cent but acquisitions accounted for 5 per cent of this increase. The remaining increase of 4 per cent primarily financed the increased sales volumes achieved during the year. Overall retail banking product sales were 14 per cent higher than in 2000.

Customer lending and deposits continue to grow well with increases in market shares being achieved in many of our core retail markets. The net interest margin, excluding the impact of the funding cost of Scottish Widows, was 3.66 per cent, compared with 3.70 per cent in 2000. This reduction was more than compensated for by increased volumes and growth in other income. Non-interest income now represents 48 per cent of total income. The efficiency ratio improved to 42.9 per cent compared with 43.4 per cent in 2000. Profit attributable to shareholders increased by 8 per cent, earnings per share increased by 7 per cent to 57.6p and economic profit increased by 6 per cent to £2,204 million. The post-tax return on average shareholders' equity was 29.1 per cent. The post-tax return on average assets was 1.84 per cent, and the post-tax return on average risk-weighted assets was 3.20 per cent.

On a statutory basis, profit before tax fell by £310 million, or 8 per cent, to £3,550 million from £3,860 million in 2000. This reduction was driven by adverse short-term fluctuations in investment earnings, totalling £648 million, caused by the overall fall in stockmarket values. Shareholders' equity increased by 7 per cent, however earnings per share fell by 8 per cent to 45.2p. The post-tax return on average shareholders' equity was 23.5 per cent.

Our bancassurance strategy continues to deliver positive results. Profit before tax, on a business as usual basis, from UK Retail Financial Services, which encompasses UK Retail Banking, Mortgages, and Insurance and Investments, increased by £99 million, or 3 per cent, to £3,189 million from £3,090 million in 2000. The trading surplus increased by 6 per cent to £3,788 million.

Pre-tax profit from UK Retail Banking fell by £143 million, or 18 per cent, to £633 million. This reduction in profitability reflects the substantial investments that have been made to support future growth including the introduction of improved products and services. In addition, during 2001 the Group invested heavily in improving customer service in the branch network and in the implementation of a number of customer relationship management initiatives which supported the 14 per cent product sales growth during the year. These investments will help to increase cross sales and improve customer loyalty in recognition that the retail banking business is a key recruitment vehicle for the sale of all our extensive range of bancassurance products, much of the profitability of which is reflected in other divisions.

Despite intense competition in the mortgage market, pre-tax profit from Mortgages increased by £66 million, or 7 per cent, to £955 million from £889 million in 2000. The Group's key objective during 2001 has been to grow its mortgage lending prudently but profitably. As a result of this focus net new lending was lower than the Group's natural market share but profitability improved strongly. Gross new lending increased by 22 per cent to £14.0 billion, compared with £11.5 billion a year ago. Net new lending was £3.9 billion resulting in an estimated market share of net new lending of 7.1 per cent. Net new lending in the second half of 2001 was £2.1 billion, compared with £1.8 billion in the first half of the year. The Group continues to be one of the most efficient mortgage providers in the United Kingdom.

Operating profit from Insurance and Investments increased by 12 per cent to £1,601 million from £1,425 million. The Group continues to see the benefits from the acquisition of Scottish Widows in 2000 with a 6 per cent growth in proforma weighted sales in life, pensions and unit trusts to £754.7 million. This 6 per cent growth reflected a 31 per cent increase in weighted sales from life and pensions, offset by a 31 per cent reduction in weighted sales from unit trusts, caused by the downturn in the market during the second half of 2001. Operating profit from our life and pensions business increased by £116 million, or 15 per cent, to £914 million. Operating profit from general insurance operations, comprising underwriting and broking, rose by £81 million, or 14 per cent, to a record £668 million, mainly as a result of continued strong sales growth in all major product lines.

summary of group results (continued)

Wholesale Markets pre-tax profit increased by £191 million, or 26 per cent, to £937 million as all businesses performed strongly. In addition to the impact of the acquisition of Chartered Trust there was strong customer lending growth in Corporate and Commercial Banking, and good contributions from Corporate and Commercial Banking, Treasury Division, Lloyds TSB Asset Finance and Lloyds TSB Registrars.

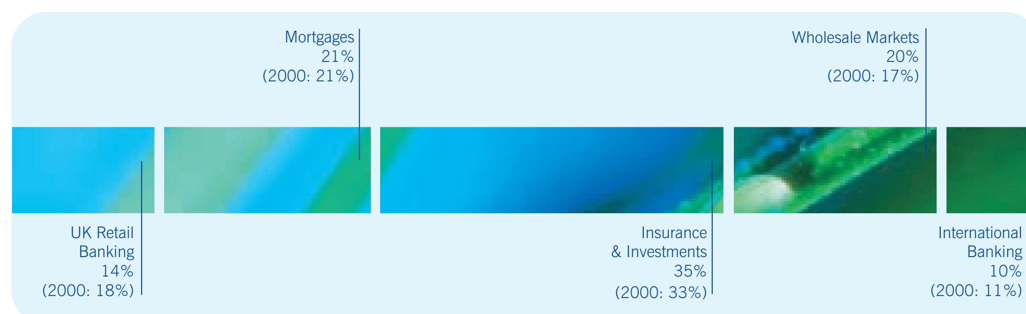
International Banking pre-tax profit was £33 million lower at £444 million compared with 2000, as a result of a £100 million reduction in pre-tax profit caused by the recent economic difficulties in Argentina. Profits from New Zealand in local currency terms increased by 17 per cent, but after the effect of exchange rate movements profits from The National Bank of New Zealand increased by 13 per cent to £165 million. Our consumer finance business in Brazil, Losango Consumer Finance, made a pre-tax profit of £43 million, compared with £41 million in 2000. Recent events in Argentina have led to profit before tax in 2001 being reduced by £100 million to reflect an increase in the general provision of £55 million, as a measure of prudence, and a £45 million write down of Argentine Government debt.

The total Group charge for bad and doubtful debts, excluding the general provision in respect of Argentina, was 28 per cent higher at £692 million, compared with £541 million in 2000. The domestic charge increased to £570 million from £426 million, partly as a result of the Chartered Trust acquisition, but also as a result of a £30 million provision made against the Group's loans and advances to one specific corporate customer, which total some £70 million. In addition, during 2000 UK Retail Banking had a one-off benefit of £42 million following the full centralisation of its arrears processing.

Excluding the general provision in respect of Argentina, provisions overseas increased to £122 million from £115 million. The Group's charge for bad and doubtful debts, expressed as a percentage of average lending and excluding the general provision relating to Argentina, was 0.57 per cent compared to 0.50 per cent in 2000. At the end of the year provisions for bad and doubtful debts for the Group totalled £1,468 million, representing over 120 per cent of non-performing loans (2000: 113 per cent) and, notwithstanding the general slowdown in global economic growth, the level of non-performing loans decreased slightly to £1,222 million, compared with £1,259 million in December 2000. Our high quality lending portfolio remains heavily influenced by our mortgage business and, throughout our business, we continue to be well positioned for any economic slowdown.

The total capital ratio was 9.2 per cent and the tier 1 capital ratio was 8.4 per cent. Balance sheet assets increased by £18 billion, or 8 per cent, to £237 billion from £219 billion at the end of 2000. Loans and advances to customers increased by £9 billion, or 7 per cent. Risk-weighted assets increased by 16 per cent to £108.8 billion from £94.0 billion at the end of 2000.

quality of **earnings**



excluding central group items

profit before tax by main businesses

UK Retail Financial Services

Total profit before tax on a business as usual basis from UK Retail Financial Services, which encompasses UK Retail Banking, Mortgages, and Insurance and Investments, increased by £99 million, or 3 per cent, to £3,189 million from £3,090 million in 2000. The trading surplus increased by 6 per cent to £3,788 million.

Over the last few years, a substantial amount of investment has been made to develop our revenue growth initiatives and underpin the future profitability of our core retail financial services businesses. Much of this investment has been completed, all initiatives have clearly defined payback periods and strong growth across all areas of UK Retail Financial Services is now beginning to be seen. We are very confident that our retail strategies will deliver superior growth in the future.

One of the key elements of our strategy has been our investment in Customer Relationship Management (CRM). Our CRM programme is now fully operative and independent benchmarking has confirmed that we are now truly world class in the deployment of CRM throughout the Group. Our CRM systems, supported by a suite of predictive modelling tools, are beginning to generate substantially more sales leads than ever before and our in-branch information systems have materially enhanced the ability of our staff to identify individual customers' needs and to fulfil those needs.

We continue to follow a strategy of differentiation through segmentation and we have developed our retail strategy around four principal customer segments. We are now beginning to tailor our products and services to meet the specific needs of these segments and we have improved our product range to be more innovative and attractive than it has ever been.

UK Retail Banking and Mortgages

Total profit before tax from UK Retail Banking and Mortgages decreased by £77 million, or 5 per cent, to £1,588 million. Total income increased by £162 million, or 4 per cent, to £4,256 million. Net interest income increased by £164 million, or 6 per cent, to £3,115 million. Personal loans and credit card lending increased by 18 per cent and balances on current accounts and savings and investment accounts grew by 9 per cent. Mortgage balances outstanding increased by 7 per cent to £56.6 billion.

Operating expenses increased by £144 million, or 7 per cent, to £2,243 million during 2001, compared to £2,099 million in 2000. This partly reflected the £202 million of investment expenditure in the Group's revenue growth businesses, information technology integration and e-commerce in 2001, compared to £192 million in 2000, and was partly due to increased costs as a result of the recruitment of additional service and sales staff into the branch network.

Other income decreased by £2 million to £1,141 million. There was a £21 million improvement in income earned from credit and debit cards, and increased income from added value current accounts and profits on the sale and leaseback of premises. These reflect the Group's ongoing strategy, started some years ago, to sell and lease back a number of its branches and create greater future flexibility in the changing high street environment. This was partly offset by a £76 million reduction in ATM fees and planned reductions in unauthorised borrowing fees, and the impact of lower stockmarket related fees.

Bad debt provisions increased by £83 million, or 25 per cent, to £415 million. During 2000, UK Retail Banking had a one-off benefit of £42 million following the full centralisation of its arrears processing. In 2001 growth in provisions against personal loan and credit card balances, reflecting strong growth in the size of both portfolios, was offset by a £32 million release of general provisions relating to our mortgage business.

UK Retail Banking and Mortgages (continued)

	2001 £m	2000 £m
Net interest income	**3,115**	2,951
Other income	**1,141**	1,143
Total income	**4,256**	4,094
Operating expenses	**2,243**	2,099
Trading surplus	**2,013**	1,995
Provisions for bad and doubtful debts	**415**	332
Income from associated undertakings and joint ventures	**(10)**	2
Profit before tax	**1,588**	1,665
Profit before tax:		
Retail Banking	**633**	776
Mortgages	**955**	889
	1,588	1,665
Efficiency ratio	**52.7%**	51.3%
Total assets (year-end)	**£77.9bn**	£71.3bn
Total risk-weighted assets (year-end)	**£48.1bn**	£44.0bn

UK Retail Banking has the responsibility for managing the core relationship with our current account customers and, therefore, acts as the principal gateway for the cross-sale of our full range of bancassurance products and services. As such it contributes significantly to the profitability of other businesses, particularly in our life and pensions, and general insurance businesses.

Pre-tax profit from UK Retail Banking decreased by £143 million, or 18 per cent, to £633 million. The last few years have seen a significant period of transition within UK Retail Banking as the Group has proactively repositioned the business for future development and growth, in the increasingly competitive and regulated environment in which the Group operates. This extensive repositioning has included substantial investment in infrastructure, improved products, a revised fee structure and higher staff numbers in customer facing sales and support areas. This has clearly had a short-term impact on profitability but we are confident that the business is now better positioned for sustainable future profit growth.

During 2001, these improved products and services have brought about the planned reduction in margins on certain personal loan products, together with reductions in fee income in areas such as unauthorised borrowing fees and ATM charges. All of these product and service enhancements have substantially improved the Group's customer proposition and have been a key factor in the delivery of a 14 per cent increase in retail banking product sales during 2001.

The Group has also continued to develop and remodel many product offers to help maintain market-leading positions in most of its core markets, including personal current accounts, savings and business banking. The popularity of the Group's added value current accounts continued with Lloyds TSB maintaining its market leadership in this area with over 3 million customers now using these accounts. In addition the Group has substantially enhanced its broader product range with new and innovative savings products and a wider range of more competitive personal loan and credit card services. In many cases these are supported by internet technology extending product distribution and improving operating efficiency.

We have continued to develop our distribution channels in order to offer the broadest possible range of access points for our customers to improve service and to enhance revenue growth. Our branch network of over 2,100 branches provides a comprehensive base for the servicing and the recruitment of existing, and potential, customer needs. *LloydsTSB.com,* our internet banking system, continues to grow rapidly and now has 1.8 million registered customers. It is consistently one of the most visited financial websites in Europe. In addition to being able to conduct banking transactions over the internet, our customers can purchase products and services at a time more convenient to them.

UK Retail Banking and Mortgages (continued)

During 2001, our online product and service functionality has continued to grow and customers can now undertake a broad range of banking services online. Total online sales during the year exceeded 110,000 products and these included personal loans, savings accounts, mortgages, credit cards and a wide range of insurance products. During 2002 we expect to widen further the range of products available online to include added value current accounts, overdrafts and travel money, and see further significant increases in online product sales. Our telephone banking operation, comprising PhoneBank and PhoneBank Express, our leading edge interactive voice recognition system, is one of the largest in Europe and now has 2.5 million customers. PhoneBank and PhoneBank Express handled some 25 million calls during 2001.

During the year, Business Banking rolled-out an innovative new customer needs based proposition, to make it easier for people to start up in business and to reduce the number of businesses ceasing to trade within their first few years. Our small business internet portal, *success4business.com*, designed to deliver business and financial solutions to our customers' ongoing needs, now has over 77,000 registered users. Customer deposit balances have increased by 5 per cent and this has been accompanied by high levels of sales of insurance, mortgages and investment products, helped increasingly by a close working relationship with Scottish Widows and Cheltenham & Gloucester.

Revenues in the Group's wealth management businesses were reduced by some £33 million as a result of lower stockmarket levels, and the subsequent reduction in demand for wealth management products. The Group's new wealth management brand, Create, was launched in October. The Create offer aims to meet the differing needs of the Group's affluent customers who will be the target market for the wealth management services which embrace current account banking through to personalised asset management services. The Group remains a significant player in the UK wealth management market with over 40,000 clients and some £11 billion of funds under management.

Mortgages	**2001**	2000
Profit before tax	**£955m**	£889m
Efficiency ratio	**20.2%**	21.6%
Gross new mortgage lending	**£14.0bn**	£11.5bn
Market share of gross new mortgage lending	**8.7%**	9.6%
Net new mortgage lending	**£3.9bn**	£4.6bn
Market share of net new mortgage lending	**7.1%**	11.3%
Mortgages outstanding (year-end)	**£56.6bn**	£52.7bn
Market share of mortgages outstanding	**9.5%**	9.8%

Despite intense competition in the mortgage market, pre-tax profit from Mortgages increased by £66 million, or 7 per cent, to £955 million from £889 million in 2000. The Group's key objective is to grow its mortgage lending prudently but profitably. As a result of this focus, net new lending was lower than the Group's natural market share but profitability improved strongly. Gross new lending increased by 22 per cent to £14.0 billion, compared with £11.5 billion a year ago, and net new lending was £3.9 billion resulting in an estimated market share of net new lending of 7.1 per cent. Net new lending in the second half of 2001 was £2.1 billion, compared with £1.8 billion in the first half of the year, and our pipeline of new business at the end of 2001 should give the Group a good start to 2002.

Mortgages are also a key recruitment product for other retail products and services as we typically sell over 3.5 additional products, primarily insurance, alongside the sale of a mortgage. In 1996 only one in eight Lloyds Bank customers and one in six TSB customers, who took out a mortgage, did so with the Group. One in four of all our customers with a mortgage now have their mortgage with the Group. This is a significant indicator of the success of the Group's mortgage strategy.

The efficiency ratio of the Group's total mortgage business was 20.2 per cent compared with 21.6 per cent in 2000. The Group continues to be one of the most efficient mortgage providers in the UK. C&G continues to benefit from mortgage sales distribution through the Lloyds TSB branch network, the IFA market and from the strength of the C&G brand. In addition C&G Teledirect, its internet and telephone operation, continued to perform strongly. Business levels sourced from intermediaries remain strong.

UK Retail Banking and Mortgages (continued)

A relatively stable arrears position and the beneficial effect of house price increases have meant that bad debt provisions remained at low levels, resulting in a release of £32 million of the Group's mortgage general provision. Consequently new provisions were more than offset by releases and recoveries resulting in a net provisions credit of £24 million for the year, compared with a net credit of £13 million in 2000. The quality of our mortgage lending continues to be very satisfactory and we remain well positioned for any slowdown in economic growth.

Insurance and Investments

(the life, pensions and unit trust businesses of Scottish Widows and Abbey Life; general insurance underwriting and broking; and Scottish Widows Investment Partnership)

	2001 £m	2000 £m
Life, pensions and unit trusts:		
Scottish Widows	**715**	629
Abbey Life	**199**	169
	914	798
General insurance	**668**	587
Operating profit from Insurance	**1,582**	1,385
Scottish Widows Investment Partnership	**19**	40
Total operating profit	**1,601**	1,425
Short-term fluctuations in investment returns (page 32)	**(648)**	(94)
Changes in economic assumptions (page 33)	**–**	127
Pension provisions/stakeholder pension related charge (page 33)	**(70)**	(180)

Scottish Widows has now been fully integrated into the Group, sales and profitability are improving, and we are confident that the various financial targets we set on completion of the acquisition will be achieved, good progress already having been made. Operating profit from Insurance and Investments increased by 12 per cent to £1,601 million from £1,425 million in 2000.

Operating profit from our life, pensions and unit trusts businesses increased by £116 million, or 15 per cent, to £914 million. The market for medium and long-term investments was adversely affected in the second half of the year, as a consequence of the events of September 11 and the general decline in global stockmarkets. However, over the last 12 months the growth in the sales of Scottish Widows' life and pensions products has exceeded overall market growth, and we are confident of further progress in 2002 and beyond.

On a proforma basis, including Scottish Widows sales figures for the full 12 months of 2000, total sales from the Group's life, pensions and unit trust businesses were £4,423.5 million, compared with £4,742.8 million in 2000. Overall weighted sales were £754.7 million compared to £711.0 million last year, an increase of 6 per cent. New business performance in 2000 was helped by the reinvestment of some demutualisation proceeds into company pension schemes.

The overall 6 per cent growth in weighted sales reflected a 31 per cent increase in weighted sales from life and pensions, offset by a 31 per cent reduction in weighted sales from unit trusts, largely caused by the downturn in the market during the second half of 2001.

The 31 per cent growth in weighted sales from life and pensions, from £423.6 million in 2000 to £556.1 million in 2001, resulted in an increase in market share well ahead of our expectations.

There was strong growth in regular premium pension sales, boosted by the launch of stakeholder pensions. This contributed to a 65 per cent increase in life and pensions regular premium product sales. Single premium life and pensions product sales increased by 8 per cent but, following a general market decline in the unit trusts and Individual Savings Account (ISA) markets, unit trust sales decreased by 31 per cent. Nevertheless, Scottish Widows was, during 2001, confirmed by the Association of Unit Trusts and Investment Funds providers (AUTIF) as the leading ISA provider in the UK and the Group remains well positioned in this sector of the market.

Insurance and Investments (continued)

Scottish Widows is also well placed to take advantage of the opportunities in the stakeholder pensions market. During 2001, Scottish Widows became the nominated stakeholder pensions provider for a number of associations and employers which gives access to more than 46,000 employers, an estimated market share of 16 per cent. Over 20,000 employers have already designated Scottish Widows as their stakeholder pensions provider, resulting in 837,000 employees being offered stakeholder pensions. In 2001, weighted sales of stakeholder pension products totalled £76 million, an estimated 15 per cent market share. The business remains relatively immature but, with the growing size of our portfolio, we expect stakeholder pensions to make a good contribution to ongoing profits.

Operating profit from general insurance operations, comprising underwriting and broking, rose by £81 million, or 14 per cent, to a record £668 million, mainly as a result of continued strong revenue growth from creditor and home insurance. With over 8 million general insurance policies in force, we believe the Group has market leadership in home, creditor and travel insurance.

The principal focus of Scottish Widows Investment Partnership (SWIP) is the delivery of consistent superior investment performance. During 2001 Scottish Widows Investment Management and Hill Samuel Asset Management were fully integrated into SWIP. A complete overhaul of the management structure has also been undertaken, together with a fundamental review of investment philosophy, processes and systems. Pre-tax profits from SWIP for the year were £19 million compared with £40 million in 2000, the reduction in profitability partly being driven by lower stockmarket levels. At the end of the year SWIP had £78 billion of funds under management, out of Groupwide funds under management totalling £109 billion. Having created a top class investment management team, SWIP is already demonstrating a strong turnaround in performance and we are confident that, following all the changes made during 2001, overall fund management performance will continue to improve in 2002 and beyond.

Life and pensions and unit trusts	2001 £m	2000* £m
New business	362	297
Existing business		
– expected return	374	334
– experience variances	37	36
– assumption changes and other items	95	96
	506	466
Investment earnings	247	212
Life and pensions distribution costs	(247)	(225)
	868	750
Unit trusts	143	157
Unit trust distribution costs	(97)	(109)
	46	48
Operating profit	914	798
New business margin (life and pensions)	20.7%	18.5%

* *New business income has been restated to include all income earned on new business during the year. This treatment is consistent with standard industry practice*

New business income increased by 22 per cent and existing business profits rose 9 per cent, partly as a result of the inclusion of Scottish Widows for the full year, compared with only 10 months in 2000. During the year the life and pensions new business margin, defined as new business income less distribution costs divided by weighted sales, increased to 20.7 per cent, from 18.5 per cent in 2000. The improvement largely arising from cost efficiencies driven by process enhancements, together with an improved product mix.

Profit before tax from existing business increased by 9 per cent from £466 million to £506 million. The expected return from existing business increased by £40 million, or 12 per cent, to £374 million. This reflects the unwinding of the long-term discount rate applied to the expected cash flows from the Group's portfolio of in-force business.

Insurance and Investments (continued)

It is standard practice for life companies to regularly review the underlying assumptions that support the embedded value calculations, taking into account the latest experience in respect of customer lapse rates, expense inflation, investment mix, mortality rates and other similar items. It is our normal practice to undertake a full review in December each year, which has historically led to some profit and loss account benefit. In 2000 the review, together with some tax-related adjustments, resulted in a benefit of £96 million. In 2001 this review, together with the planned harmonisation of actuarial models between Scottish Widows and other Group life companies, resulted in a benefit of £95 million, on combined policyholders' funds of over £46 billion.

The adequacy of the provision for redress to past purchasers of pension policies has been reviewed in the light of ongoing experience and, given that the review is now beginning to draw to a conclusion, greater certainty as to the number and size of compensation claims likely to be paid. Lower stockmarket levels have had a significant impact on total redress costs as the cost of restitution into company pension schemes rises as personal pension fund values reduce. As a result therefore, the cost of redress is forecast to increase by £70 million and an additional provision of this amount has been made. This brings the total provision charged for this purpose to £972 million, of which £897 million had been used at 31 December 2001. The pension review process should be substantially complete by 30 June 2002 and, given the closeness to completion, the Group believes that the overall level of provisions remaining will be sufficient to cover its outstanding liabilities.

After an extensive review of its existing practices carried out in the light of the judgement of the House of Lords in the guaranteed annuities case *Equitable Life vs Hyman*, Scottish Widows revised the way it calculates benefits for guaranteed annuity policies, with effect from 1 February 2002. As a result of this change, the terminal bonuses for most guaranteed annuity option policies will be increased, as announced on 31 January 2002. Under the terms of the transfer of Scottish Widows' business to the Lloyds TSB Group in March 2000, an Additional Account was set up within the With Profits Fund. This Account had a value, at 31 December 2001, of approximately £1.7 billion and is available to meet any additional costs of providing guaranteed benefits on transferred policies, including guaranteed annuity option policies. The assets allocated to the Additional Account include certain hedge assets, to provide protection to the With Profits Fund against the consequences of a future fall in interest rates.

The Group currently expects that the most likely outcome is that the balance in the Additional Account will be sufficient to meet the cost of the enhanced benefits payable to the guaranteed annuity options policyholders, as well as other contingencies. This cost, currently estimated to be approximately £1.4 billion, will be paid out over many years as policies mature. In the event that the amount in the Additional Account proves, over time, to be insufficient to meet these costs, the shortfall will be met by the Group. No provision is considered necessary for such risk.

In 1998, a provision was made within Abbey Life for liabilities under certain unit linked products with guaranteed annuity options written in the mid-1960s to the mid-1980s. The total provision charged for this purpose is £152 million and, at 31 December 2001, £79 million remained outstanding. We remain confident this provision will be sufficient to cover these liabilities.

Insurance and Investments (continued)

	2001 £m	2000* £m	Proforma 2000* £m
Total new business premium income			
Regular premiums:			
Life – mortgage related	**24.7**	23.6	24.9
– non-mortgage related	**19.9**	19.2	22.0
Pensions	**232.8**	105.2	118.1
Health	**4.6**	5.6	5.7
Total regular premiums	**282.0**	153.6	170.7
Single premiums:			
Life	**1,684.2**	1,196.5	1,283.3
Annuities	**338.6**	327.1	352.5
Pensions	**718.2**	830.8	892.9
Total single premiums	**2,741.0**	2,354.4	2,528.7
External unit trust sales:			
Regular payments	**65.0**	90.9	92.3
Single amounts	**1,335.5**	1,899.1	1,951.1
Total external unit trust sales	**1,400.5**	1,990.0	2,043.4
Weighted sales (regular + 1/10 single)			
Life and pensions	**556.1**	389.1	423.6
Unit trusts	**198.6**	280.8	287.4
Life, pensions and unit trusts	**754.7**	669.9	711.0
Weighted sales by distribution channel:			
Branch network	**376.2**	353.3	353.3
Independent financial advisers	**279.8**	254.9	280.7
Direct	**98.7**	61.7	77.0
Life, pensions and unit trusts	**754.7**	669.9	711.0

	£bn	£bn
Group funds under management		
Scottish Widows Investment Partnership	**78**	87
UK Wealth Management	**11**	12
International	**20**	23
	109	122

* *the Group disposed of the new business capability of Abbey Life on 1 February 2000 and weighted sales totalling £5.9 million are therefore excluded from 2000 comparatives*

Insurance and Investments (continued)

General Insurance

	2001 £m	2000 £m
Premium income from underwriting:		
Creditor	**110**	126
Home	**281**	228
Health	**45**	50
Re-insurance premiums	**(8)**	(5)
	428	399
Commissions from insurance broking:		
Creditor	**323**	225
Home	**41**	34
Health	**22**	19
Other	**142**	120
	528	398
Operating profit	**668**	587

Our general insurance operations, comprising both underwriting and broking activities, had a record year and operating profits rose by £81 million, or 14 per cent, to £668 million.

Premium income from underwriting increased by £29 million, or 7 per cent, largely as a result of higher home insurance sales which increased by 23 per cent. Commissions from insurance broking increased by £130 million, or 33 per cent, as a result of higher levels of creditor insurance and growth in all major product lines. There was a £22 million increase in other broking commissions reflecting a benefit of £30 million resulting from a one-off change in broking commission arrangements.

New business sales of 2.7 million products were 10 per cent higher than last year with home, creditor and motor business all growing strongly. Overall income from creditor insurance increased by 23 per cent, reflecting higher personal sector loan volumes. Sales of home insurance policies increased by 23 per cent to 1,124,000. Overall sales from the branch network increased by 4 per cent and direct channels, comprising direct mail, telephone and internet, increased by 23 per cent.

Claims were £32 million, or 23 per cent, higher at £174 million than in 2000. The overall claims ratio of 40 per cent was higher than last year (35 per cent) reflecting higher property claims in line with rising volumes of new business, partly offset by lower creditor insurance claims.

As a leading distributor of general insurance products, Lloyds TSB now has over 8 million policies in force and we believe the Group has UK market leadership in home, creditor and travel insurance.

Wholesale Markets

(banking, treasury, large value lease finance, long-term agricultural finance, share registration, venture capital, factoring and invoice discounting, and other related services for major UK and multinational companies, banks and financial institutions, and medium-sized UK businesses; and Lloyds TSB Asset Finance)

	2001 £m	2000 £m
Net interest income	**1,094**	900
Other income	**862**	621
Total income	**1,956**	1,521
Operating expenses	**849**	667
Trading surplus	**1,107**	854
Provisions for bad and doubtful debts	**155**	94
Amounts written off fixed asset investments	**15**	14
Profit before tax	**937**	746
Efficiency ratio	**43.4%**	43.9%
Total assets (year-end)	**£79.4bn**	£66.4bn
Total risk-weighted assets (year-end)	**£45.4bn**	£36.5bn

Wholesale Markets pre-tax profit increased by £191 million, or 26 per cent, to £937 million. The acquisition of Chartered Trust in September 2000 had a significant impact on the figures within Wholesale Markets. In 2001 Chartered Trust contributed £116 million of net interest income (2000: £31 million), after funding costs of £25 million (2000: £12 million), £179 million of other income (2000: £53 million), £237 million of operating expenses (2000: £71 million), provisions for bad and doubtful debts of £39 million (2000: £12 million) and £19 million profit before tax (2000: £1 million).

Excluding the impact of Chartered Trust, net interest income increased by £109 million resulting primarily from positive interest rate management and asset growth. Other income increased by £115 million, excluding the impact of Chartered Trust. This increase largely resulted from increased operating lease rentals of £54 million from Lloyds TSB Leasing and Lloyds UDT. There was also a £26 million increase from higher fees from large corporate activity, factoring and following the completion of a number of high quality structured finance transactions. Excluding Chartered Trust, operating expenses increased by £16 million of which £13 million was in respect of increased operating lease depreciation. Other costs in the year were therefore held flat.

Excluding Chartered Trust, the charge for provisions for bad and doubtful debts in Wholesale Markets increased by £34 million. The charge relating to the corporate and commercial lending portfolios increased by £53 million largely as a result of new provisions required against a small number of corporate exposures, notably a £30 million provision made against the Group’s loans and advances to one specific corporate customer, which total some £70 million. The Group constantly reviews all of its lending portfolios and remains satisfied that its prudent lending approach will continue to ensure that the Group’s lending book is well positioned for any economic slowdown. There was an £18 million reduction in the charge against the consumer finance portfolio of Lloyds UDT due to improved credit control procedures.

Assets grew by 20 per cent to £79.4 billion, an increase of £13 billion. Of this increase, over £9 billion resulted from a growth in debt securities reflecting an increase in the Group’s portfolio of asset backed and other investment grade securities, many of which were triple A rated. A high percentage of these assets, which are very liquid and marketable, have low capital weightings and represent a profitable deployment of the Group’s capital at a time when margins are improving. The residual growth in assets reflects an increase in Government guaranteed export credit transactions and general growth in our Wholesale operations. The Group has no exposure to high yield junk bonds.

Our Treasury operations achieved good profitable growth as interest rates fell. The Group’s risk-based activity in the derivatives markets continues to remain largely focused on straight cash based products in support of our customers’ transactions.

Wholesale Markets (continued)

Lloyds TSB Leasing maintained its position as the largest 'big ticket' leasing company in the UK and is now an established provider of operating leases within its chosen market sectors. Lloyds TSB Registrars had another very successful year with fee income growing by 18 per cent and pre-tax profits by 22 per cent, to £55 million. At the end of the year our registration market share of FTSE 100 companies had increased to 61 per cent and market leadership has been maintained in the important market for employee share administration services.

Lloyds TSB Development Capital had another good year expanding its regional representation in the UK, achieving record levels of venture capital investment and a high level of realisations of venture capital gains, which contributed to pre-tax profits of £37 million.

Following the acquisition of Chartered Trust, the Group has now combined the activities of Lloyds UDT and Chartered Trust to create Lloyds TSB Asset Finance. This has consolidated the Group's position as market leader in the independent provision of motor finance. Lloyds TSB is also one of the leading contract hire providers in the UK and through our motor direct operation we are now successfully beginning to sell new and used cars to our 16 million retail customers. Trading conditions have been in line with our expectations at the time of acquisition, market share is increasing and we are on track to achieve our financial projections and anticipated cost synergies.

International Banking

(banking and financial services overseas in four main areas: The Americas, New Zealand, Europe and Offshore Banking; and Emerging Markets Debt)

	2001 £m	2000* £m
Net interest income	**764**	753
Other income	**463**	444
Total income	**1,227**	1,197
Operating expenses	**561**	587
Trading surplus	**666**	610
Provisions for bad and doubtful debts		
– Normal coverage	**122**	115
– General provision re Argentina	**55**	–
Amounts written off fixed asset investments	**45**	18
Profit before tax	**444**	477
Efficiency ratio	**45.7%**	49.0%
Total assets (year-end)	**£22.1bn**	£19.6bn
Total risk-weighted assets (year-end)	**£13.9bn**	£12.4bn
Profit on sale of Lloyds TSB Asset Management S.A.	**39**	–

** restated for the effect of FRS 18 (page 61, note 1)*

International Banking pre-tax profit was £33 million, or 7 per cent, lower at £444 million compared with 2000, as a result of a £100 million reduction in pre-tax profit caused by the recent economic difficulties in Argentina. Pre-tax profit from International Banking represented 10 per cent of Group pre-tax profit of which 4 per cent related to our New Zealand business, 4 per cent to our Europe and offshore banking operations, and 2 per cent to the Group's combined Emerging Markets Debt portfolio and Latin American businesses.

Net interest income increased by £11 million, or 1 per cent, to £764 million. Volume growth in New Zealand and Brazil was largely offset by the impact of adverse exchange rate movements. Other income increased by £19 million, or 4 per cent, to £463 million as an increase in Emerging Markets Debt asset sales of £51 million and a £10 million increase in fee income from New Zealand were partly offset by adverse exchange rate movements of £24 million and a reduction of £19 million in fee income from the Group's overseas wealth management businesses, reflecting lower stockmarket values.

Operating expenses reduced by £26 million. Increased costs of £13 million in New Zealand and £12 million in Brazil, which supported higher business volumes, were more than offset by a £46 million benefit from exchange rate movements.

We are following the events in Argentina very closely and, as a result of the recent economic difficulties and the subsequent devaluation of the Argentine peso, the Group has taken a write-down of £45 million against Argentine Government debt. In addition, as a measure of prudence, we have increased the Group's general provision by £55 million as a precautionary measure to take account of the potential impact of pesification and any ongoing credit difficulties in Argentina. Largely as a result of this general provision, total provisions for bad and doubtful debts in International Banking increased by £62 million to £177 million.

On 31 December 2001 the Group's total exposure to Argentina was some £715 million. The Group's local balance sheet in Argentina had assets totalling £465 million, approximately two-thirds of these were dollar denominated. Some two-thirds of the local balance sheet relates to retail and business customer lending and mortgages, with cash and liquidity, and lending to banks representing the majority of the residual balance sheet. In addition, the Group has offshore loans of some £150 million to subsidiaries of major multinational companies with Argentine operations, and some £100 million of Argentine Government bonds within the Emerging Markets Debt portfolio.

International Banking (continued)

Profits from New Zealand in local currency terms increased by 17 per cent as a result of asset growth across all business sectors, growth in the number of personal customers and higher retail deposits. After adjusting for exchange rate movements, pre-tax profits from The National Bank of New Zealand increased by 13 per cent to £165 million. Our consumer finance business in Brazil, Losango Consumer Finance, made a pre-tax profit of £43 million, compared with £41 million in 2000.

The Emerging Markets Debt portfolio contributed £111 million compared with a contribution of £78 million in 2000. Following the implementation of Financial Reporting Standard 18 (page 61, note 1) certain holdings of uncollateralised bonds have been reclassified as debt securities. Based on secondary market prices, the surplus of market value over the restated net book value of the Emerging Markets Debt investment portfolio was some £200 million (December 2000 restated: £400 million).

Central group items

(earnings on surplus capital, central costs and other unallocated items)

	2001 £m	2000 £m
Accrual for payment to Lloyds TSB Foundations	**(36)**	(34)
Earnings on surplus capital, central costs and other unallocated items	**(72)**	(84)
	(108)	(118)
Abbey National offer costs	**(16)**	–

The four independent Lloyds TSB Foundations support registered charities throughout the UK that enable people, particularly disabled and disadvantaged people, to play a fuller role in society. The Foundations receive 1 per cent of the Group's pre-tax profit, averaged over 3 years, instead of the dividend on their shareholdings. In 2002 they will receive £36 million (2001: £34 million) to distribute to charities, making them in aggregate the largest independent grant giving body in the UK.

Earnings on surplus capital, central costs and other unallocated items, was £12 million better than in 2000. A full year's funding cost of Scottish Widows, compared to 10 months in 2000, was offset by the gradual build up of surplus capital and some £30 million of benefits to Group capital from changes in the Group's interest rate hedging arrangements.

net interest income

	2001	2000
Group:		
Net interest income £m	**4,944**	4,587
Average interest-earning assets £m	**144,945**	131,022
Gross yield on interest-earning assets %	**7.84**	8.44
Interest spread %	**3.00**	2.98
Net interest margin %	**3.41**	3.50
Domestic:		
Net interest income £m	**4,224**	3,956
Average interest-earning assets £m	**121,244**	110,574
Gross yield on interest-earning assets %	**7.38**	8.07
Interest spread %	**3.12**	3.06
Net interest margin %	**3.48**	3.58
International:		
Net interest income £m	**720**	631
Average interest-earning assets £m	**23,701**	20,448
Gross yield on interest-earning assets %	**10.19**	10.40
Interest spread %	**2.43**	2.58
Net interest margin %	**3.04**	3.09

Notes:
a) Gross yield is the rate of interest earned on average interest-earning assets.
b) Interest spread is the difference between the rate of interest earned on average interest-earning assets and the rate of interest paid on average interest-bearing liabilities.
c) Net interest margin is net interest income as a percentage of average interest-earning assets.
d) The analysis of net interest income by domestic and international operations shown above is based on the location of the office recording the transaction, except for lending by the international business booked in London.

Group net interest income increased by £357 million, or 8 per cent, to £4,944 million, despite a reduction of £52 million caused by a 4 basis point reduction in the underlying net interest margin. Average interest-earning assets increased by 11 per cent to £145 billion. There was further growth in mortgages and other customer lending in the UK. The overall net interest margin decreased to 3.41 per cent, a reduction of 9 basis points. The impact of the funding cost of Scottish Widows represented 5 basis points of this 9 basis point reduction, with the residual 4 basis point decrease in the margin reflecting the increasingly competitive operating environment and a lower contribution from interest-free liabilities, caused by the lower interest rate environment.

Domestic net interest income increased by £268 million, or 7 per cent, to £4,224 million, notwithstanding a reduction of £33 million caused by a 3 basis point reduction in the underlying net interest margin. This represents 85 per cent of total group net interest income.

Average interest-earning assets increased by 10 per cent to £121 billion. Personal lending and mortgage balances grew by £6 billion and wholesale balances increased by £5 billion largely reflecting growth in the corporate and commercial businesses, and the impact of the acquisition of Chartered Trust.

The net interest margin decreased by 10 basis points, reflecting the higher funding cost of Scottish Widows, which caused a reduction of 7 basis points, and a reduction in the contribution of interest-free liabilities. The net interest margin on personal lending products fell by 5 basis points and the mortgage margin was broadly unchanged.

Net interest income from international operations increased by £89 million, or 14 per cent, to £720 million. This represents 15 per cent of total group net interest income. Strong volume growth in Brazil and New Zealand was offset by the effect of exchange rate movements. Average interest-earning assets on a local currency basis increased by 20 per cent but again this increase was partly offset by the effect of exchange rate movements. The net interest margin reduced by 5 basis points, as a result of lower margins in our Latin American businesses.

other income

	2001 £m	2000* £m
Fees and commissions receivable:		
UK current account fees	**573**	629
Other UK fees and commissions	**1,220**	1,171
Insurance broking	**528**	398
Card services	**332**	304
International fees and commissions	**269**	266
	2,922	2,768
Fees and commissions payable	**(602)**	(479)
Dealing profits (before expenses):		
Foreign exchange trading income	**158**	141
Securities and other gains	**121**	84
	279	225
Income from long-term assurance business	**865**	735
General insurance premium income	**428**	399
Other operating income	**708**	436
Total other income	**4,600**	4,084
Short-term fluctuations in investment returns	**(648)**	(94)
Changes in economic assumptions	**–**	127
Pension provisions/stakeholder pension related charge	**(70)**	(180)

** restated for the effect of FRS 18 (page 61, note 1)*

Other income increased by £516 million, or 13 per cent, to £4,600 million. This represented 48 per cent of total income. Excluding the impact of the Chartered Trust acquisition other income increased by £390 million, or 10 per cent, to £4,421 million.

Fees and commissions receivable increased by 6 per cent to £2,922 million, largely reflecting strong growth in income from insurance broking. Other UK fees and commissions increased by £49 million, or 4 per cent, from £1,171 million to £1,220 million mainly due to the inclusion in 2001 of fees earned by Chartered Trust. Unit trust and asset management fees decreased by £20 million as a result of the substantial fall in the level of stockmarket activity in the second half of the year. In addition there was also a £26 million increase in fees from large corporate and factoring activity reflecting increased transaction volumes. These factors more than offset the effect of the withdrawal of ATM fees and lower transaction volumes within the stockbroking business.

Insurance broking commission income increased by £130 million compared to 2000 with continued strong growth in creditor insurance products. Income from credit and debit cards increased by £28 million, mainly as a result of higher merchant service charges and fees. However, UK current account fee income fell by £56 million; a £28 million increase in fee income from added value current accounts was more than offset by a £51 million fall in unauthorised borrowing fees and a £40 million reduction in service charges, as part of the Group's programme to make its customer proposition more competitive.

Fees and commissions payable increased by £123 million against last year as a result of the impact of the Chartered Trust acquisition, higher reciprocity fees and an increase in package costs relating to a number of products.

Dealing profits in 2001 increased by £54 million compared with 2000 reflecting benefits from opportunities created from managing certain exposures arising within the Group's insurance businesses, an improved performance from London Treasury, and higher foreign exchange income from The National Bank of New Zealand.

Income from long-term assurance business increased by £130 million reflecting growth in new business sales in part reflecting successful sales of the Group's stakeholder pension product, and a change in the mix of new business to more profitable regular premium business. Other operating income increased to £708 million from £436 million in 2000. This reflects an increase in income from operating lease rentals, partly as a result of the acquisition of Chartered Trust, from £151 million in 2000 to £329 million in 2001. Other significant contributions to other operating income are the realisation of venture capital gains within Lloyds TSB Development Capital of £57 million, earnings on the sale and restructuring of Emerging Markets Debt investments of £109 million, and £57 million profit on the sale and leaseback of premises.

operating expenses

	2001 £m	2000 £m
Administrative expenses		
Staff:		
Salaries and profit sharing	**1,754**	1,626
National insurance	**140**	131
Pensions	**(108)**	(105)
Restructuring	**8**	47
Other staff costs	**191**	189
	1,985	1,888
Premises and equipment:		
Rent and rates	**261**	247
Hire of equipment	**18**	26
Repairs and maintenance	**110**	115
Other	**117**	109
	506	497
Other expenses:		
Communications and external data processing	**433**	394
Advertising and promotion	**152**	167
Professional fees	**89**	126
Other	**376**	306
	1,050	993
Total administrative expenses	**3,541**	3,378
Depreciation	**511**	364
Amortisation of goodwill	**39**	22
Total operating expenses	**4,091**	3,764
Efficiency ratio	**42.9%**	43.4%
Exceptional restructuring costs	**217**	188
Abbey National offer costs	**16**	–

Total operating expenses, on a business as usual basis, increased by £327 million, or 9 per cent compared with 2000. On a like-for-like basis, excluding increased costs following the acquisitions of Scottish Widows and Chartered Trust of £289 million, operating lease depreciation of £78 million (2000: £65 million), and additional investments in revenue growth businesses, e-commerce and real-time banking of £235 million (2000: £224 million), costs increased by 4 per cent to £3,489 million, from £3,358 million in 2000. Much of this increase has funded the 14 per cent growth in retail banking sales volumes achieved during the year. The efficiency ratio improved to 42.9 per cent.

Administrative expenses increased by £163 million, or 5 per cent, to £3,541 million. Staff costs increased by £97 million, or 5 per cent, reflecting the impact of the acquisition of Chartered Trust, higher staff numbers and incremental investment in revenue growth businesses.

Staff eligible to participate in the staff profit sharing scheme will receive 9 per cent of basic salary (2000: 10 per cent). The total payment will be £103 million (2000: £108 million).

Depreciation increased by £147 million. An increase of £95 million in the charge in respect of operating lease assets, of which £82 million is due to the acquisition of Chartered Trust, was partly offset by a £23 million reduction in the depreciation charge on certain ship leases. Goodwill amortisation increased by £17 million due to the amortisation of the goodwill arising on the acquisition of Chartered Trust.

operating expenses (continued)

The management of day-to-day operating costs continues to have a strong emphasis in the Group, whilst at the same time we are investing heavily in many key future growth areas of our business. Our investments in e-commerce, wealth management, and customer relationship management and segmentation programmes will improve the quality of our sales and service and improve our revenue growth prospects in 2002 and beyond. During 2001, this incremental new revenue investment totalled £235 million. In 2002 and beyond we expect the level of this new revenue investment to reduce.

exceptional restructuring costs

As part of our drive to maximise shareholder value, we are committed to achieving first quartile total shareholder return performance in comparison with a peer group of 16 national and international financial services groups. We have made good progress in this respect over the last 12 months but more needs to be done to ensure that our bottom line earnings continue to grow as robustly as possible to help achieve this goal. It is also essential that we improve our flexibility to ensure that the Group remains in a very strong position to combat any potential slowdown in the economy, and to position itself for a finer margin operating environment.

In February 2000 the Group announced a significant efficiency programme designed to support the Group's strategic aim of driving down day-to-day operating costs to improve overall efficiency and finance ongoing high levels of investment in growth businesses. The programme is spread over four years and annualised cost benefits are on track, with the targeted £75 million per annum achieved in 2001. Exceptional restructuring costs totalling £217 million were charged to the 2001 profit and loss account, and comprise mainly severance, software write-off and consultancy costs.

We have undertaken a further review to identify all opportunities to extend the efficiency programme to deliver further productivity gains. Annualised benefits from the combined programme are now expected to rise by £190 million to £600 million in 2004. The combined efficiency programme will require total exceptional restructuring costs of approximately £300 million in 2002 and £100 million in 2003, largely to fund severance and infrastructure costs. In 2004 and beyond no further 'below the line' exceptional restructuring costs are anticipated as a result of this efficiency programme. The further expenditure of approximately £170 million, which will now be incurred in 2002 beyond that previously advised, will be covered by additional cost benefits estimated at £155 million by the end of 2002, resulting in a payback of just over one year for these further costs.

	2000 £m	2001 £m	2002 £m	2003 £m	2004 £m
Exceptional restructuring costs					
Initial efficiency programme	188	217	130	60	–
Further initiatives	–	–	170	40	–
Total	188	217	300	100	–

	2000 £m	2001 £m	2002 £m	2003 £m	2004 £m
Expected annualised benefits					
Initial efficiency programme (cumulative)	–	75	145	320	410
Further initiatives (cumulative)	–	–	155	180	190
Total	–	75	300	500	600

The Group is committed to growing business as usual revenues at a materially higher rate than business as usual costs. In 2001 the Group started to benefit from the investments made in our customer relationship management and segmentation programmes, as we sold more products to more customers than ever before. We expect this positive performance to continue into 2002 and beyond, as we continue to invest for growth. The Group will therefore re-invest some of the efficiency gains achieved in the creation of new jobs to support increasing sales, enhanced customer service, and new and improved products. The enhanced efficiency programme will result in a reduction of 5,000 staff in 2002, primarily from central and support areas, whilst staff numbers in customer facing sales and service areas will increase by approximately 2,000, creating a net reduction in headcount of 3,000. It is expected that the vast majority of these reductions will be achieved through voluntary redundancy and normal staff turnover.

exceptional restructuring costs (continued)

As a result of these various initiatives we expect that our business as usual costs in 2002 will grow by no more than the rate of inflation, resulting in a further improvement in the Group's efficiency ratio and competitive position.

We will continue our clear focus on all areas of our cost base to ensure that we improve productivity wherever possible at a time when the global economic outlook is undoubtedly more uncertain than it has been for some years. These programmes will help us with our objective to deliver the level of earnings growth required each year to achieve our first quartile objective in terms of total shareholder return.

number of employees (full-time equivalent)

Staff numbers increased by 3,860 to 81,400 during the year, partly as a result of the conversion of some 1,000 staff from temporary status to permanent staff. Within UK Retail Banking staff numbers increased by 3,221 as we continue planned improvements to customer service, increased call centre capacity and a substantial increase in our branch sales activities. In Wholesale Markets staff numbers increased by 529, again largely as a result of increasing staff numbers to support higher levels of business, and in International Banking staff numbers decreased by 87.

	31 December 2001	31 December 2000
UK Retail Banking*	**47,922**	44,701
Mortgages	**3,528**	3,407
Insurance and Investments	**6,378**	6,352
Wholesale Markets	**8,980**	8,451
International Banking	**12,305**	12,392
Other	**2,287**	2,237
Total number of employees (full-time equivalent)	**81,400**	77,540

* *although the costs of distributing mortgages and insurance through the Lloyds TSB network are allocated to the mortgage and insurance businesses, the number of employees involved in these activities in the network is included under UK Retail Banking*

charge for bad and doubtful debts

The total charge for bad and doubtful debts increased to £747 million from £541 million. The domestic charge increased to £570 million from £426 million, partly as a result of the acquisition of Chartered Trust which increased the charge during the year by £27 million. During 2000, UK Retail Banking had a one-off benefit of £42 million following the full centralisation of its arrears processing. In 2001 growth in provisions against personal loan and credit card balances, reflecting strong growth in the size of both portfolios, was offset by a £32 million release of general provisions relating to our mortgage business.

The charge against the corporate and commercial lending portfolios increased by £53 million largely as a result of provisions being required against a small number of corporate exposures, reflecting the slowdown in economic growth, but also as a result of a £30 million provision made against the Group's loans and advances to one specific corporate customer, which total some £70 million. There was an £18 million reduction in the provisions made against the consumer finance portfolio of Lloyds UDT reflecting improved credit procedures. Provisions overseas increased to £177 million from £115 million, largely as a result of the £55 million general provision charge, taken as a measure of prudence, to cover ongoing credit difficulties in Argentina.

There was a net general provisions charge of £11 million as the £55 million charge relating to the ongoing economic difficulties in Argentina was partly offset by a release of £32 million in the general provision relating to the Group's mortgage portfolio.

Notwithstanding the general slowdown in global economic growth, non-performing loans improved to £1,222 million compared with £1,259 million in December 2000 and £1,205 million in June 2001 and represented 1.0 per cent of total lending, compared with 1.1 per cent in December 2000 and 1.0 per cent in June 2001. Our high quality lending portfolio remains heavily influenced by our mortgage business and we are well positioned for any continued economic slowdown. In addition, the Group maintains a constant review of all large corporate and sector exposures and is satisfied that its prudent lending approach will continue to ensure that the Group's high quality lending book remains well positioned.

charge for bad and doubtful debts (continued)

	2001 £m	2000* £m
Domestic:		
UK Retail Banking	**439**	345
Mortgages	**(24)**	(13)
Wholesale Markets	**155**	94
Total domestic	**570**	426
International Banking		
– Normal coverage	**122**	115
– General provision re Argentina	**55**	–
Total charge	**747**	541
Specific provisions	**736**	547
General provisions	**11**	(6)
Total charge	**747**	541
Charge as % of average lending:	**%**	%
(excluding general provision re Argentina)		
Domestic	**0.54**	0.45
International	**0.76**	0.80
Total charge	**0.57**	0.50

** restated for the effect of FRS 18 (page 61, note 1)*

total provisions for bad and doubtful debts

Following the implementation of FRS 18 (page 61, note 1) uncollateralised bonds previously included in loans and advances have now been reclassified as debt securities. This reduces significantly the level of provisions held. 2000 comparatives have been restated accordingly.

At the end of December 2001 provisions for bad and doubtful debts totalled £1,468 million. This represented 1.2 per cent of total lending. Non-performing lending decreased to £1,222 million from £1,259 million in December 2000. At the end of the year, total provisions represented over 120 per cent of non-performing loans.

Closing provisions as % of lending (excluding unapplied interest)	31 December 2001 £m		31 December 2000* £m	
Specific:				
Domestic	**848**	**(0.8%)**	774	(0.8%)
International	**251**	**(1.5%)**	295	(2.0%)
	1,099	**(0.9%)**	1,069	(0.9%)
General	**369**	**(0.3%)**	357	(0.3%)
Total	**1,468**	**(1.2%)**	1,426	(1.2%)

** restated for the effect of FRS 18 (page 61, note 1)*

tax

The effective rate of tax was 27.4 per cent (2000: 28.6 per cent). The lower effective rate of tax, compared with the standard tax rate of 30 per cent, is largely due to tax relief on payments to the QUEST to satisfy Save As You Earn options, and gains on disposals of investments and properties sheltered by capital losses.

capital ratios

	31 December 2001 £m	31 December 2000* £m
Capital: tier 1	**9,168**	7,949
: tier 2	**7,831**	7,722
	16,999	15,671
Supervisory deductions	**(6,960)**	(6,862)
Total capital	**10,039**	8,809
	£bn	£bn
Risk-weighted assets:		
UK Retail Banking	**19.5**	17.4
Mortgages	**28.6**	26.6
Insurance and Investments	**0.2**	0.2
UK Retail Financial Services	**48.3**	44.2
Wholesale Markets	**45.4**	36.5
International Banking	**13.9**	12.4
Central group items	**1.2**	0.9
Total risk-weighted assets	**108.8**	94.0
Risk asset ratios: total capital	**9.2%**	9.4%
: tier 1	**8.4%**	8.5%
Post-tax return on average risk-weighted assets		
– statutory basis	**2.53%**	3.10%
– business as usual basis	**3.20%**	3.38%

** restated for the effect of FRS 18 (page 61, note 1)*

Notes:

a) Tier 1 capital comprises mainly shareholders' funds and minority interests.

b) Tier 2 capital comprises loan capital and the general provision for bad and doubtful debts.

c) Supervisory deductions comprise mainly the investment in the insurance businesses.

At the end of December 2001 the risk asset ratios were 9.2 per cent for total capital and 8.4 per cent for tier 1 capital.

In 2001, total capital for regulatory purposes increased by £1,230 million to £10,039 million. Tier 1 capital increased by £1,219 million, mainly from retained profits and the issue of tax efficient capital instruments. Tier 2 capital increased by £109 million and supervisory deductions increased by £98 million.

Risk-weighted assets increased to £108.8 billion and the post-tax return on average risk-weighted assets, a key measure of efficient use of capital, was 2.53 per cent on a statutory basis and 3.20 per cent on a business as usual basis.

Abbey National offer costs

These relate to costs incurred in connection with the proposed acquisition of Abbey National plc prior to the announcement by the Secretary of State for Trade and Industry that Lloyds TSB would not be permitted to proceed with an offer.

profit on sale of Lloyds TSB Asset Management S.A.

In October 2001, the Group sold its Brazilian fund management and private banking business, including its subsidiary Lloyds TSB Asset Management S.A., to Banco Itaú S.A. The net asset value of the business sold was less than £2 million and assets under management were approximately US$2.0 billion. The sale of this business did not affect the Group's other Brazilian businesses. The profit before tax on the sale of £39 million has been included in the accounts of the Group for the year ended 31 December 2001.

shareholder returns

Dividends of £1,872 million (an increase of 10 per cent per share) are covered 1.3 times by earnings. Profit of £628 million will be retained in the business. Total shareholders' funds grew by £736 million, or 7 per cent, to £10,760 million (191p per share) from £10,024 million (180p per share) at the end of 2000.

Since the merger between Lloyds Bank and TSB six years ago, the Group's share price has risen by 115 per cent. An investment of £1,000 in Lloyds TSB shares on 1 January 1996, with dividends reinvested in each year, was worth £2,763 at the end of 2001, a compound annual growth rate of over 18 per cent. On the same basis, an investment of £1,000 in the FTSE All-Share index would be worth £1,662.

economic profit

In pursuit of our aim to maximise shareholder value, we use a system of value based management as a framework to identify and measure value in order to help us make better business decisions. Accounting profit is of limited use as a measure of value creation and performance as it ignores the cost of the equity capital that has to be invested to generate the profit. We choose economic profit as a measure of performance because it captures both growth in investment and return. Economic profit represents the difference between the earnings on the equity invested in a business and the cost of the equity. Our calculation of economic profit uses average equity for the year and is based on a cost of equity of 9 per cent (2000: 9 per cent).

Economic profit instils a rigorous financial discipline in determining investment decisions throughout the Group. It enables us to evaluate alternative strategies objectively, with a clear understanding of the value created by each strategy, and then to select the strategy which creates the greatest value.

short-term fluctuations in investment returns

In accordance with generally accepted accounting practice in the UK, it is the Group's accounting policy to carry the investments comprising the reserves held by its life companies at market value. In the past, this has not had a significant impact upon the Group's results because of the limited reserves necessary to support the predominantly unit-linked business of Lloyds TSB Life and Abbey Life. However, the reserves held to support the with-profits business of Scottish Widows are substantial and changes in market values will result in significant volatility in the Group's embedded value earnings. In addition, the movement in the embedded value in the balance sheet includes experience variances related to movements in the market value of the funds. Consequently, in order to provide a clearer representation of the underlying performance, the results of the life and pensions business are analysed between an operating profit, including investment earnings calculated using longer-term investment rates of return, and a profit before tax, separately identifying the short-term fluctuations in investment returns.

The longer-term rates of return for the period are consistent with those used by the Group in the calculation of the embedded value at the beginning of the period, which were 8.00 per cent for equities and 5.25 per cent for gilts. These are based upon a long-term view of economic activity and are therefore not adjusted for market movements which are considered to be short term. This approach is considered the most appropriate given the long-term nature of the portfolio of products and achieves consistency in reporting from one period to the next.

Lloyds TSB General Insurance also holds investments to support its underwriting business; these are carried at market value and gains and losses included within dealing profits. Consistent with the approach adopted for the life and pensions business, an operating profit for the general insurance business is calculated including investment earnings normalised using the same long-term rates of return.

short-term fluctuations in investment returns (continued)

During 2001 the FTSE All-Share index fell by 15 per cent and this created adverse short-term fluctuations in investment returns totalling £648 million. These adverse short-term fluctuations should not represent a permanent impairment to the value of the Group's reserves which fluctuate as stockmarket values fluctuate.

changes in the economic assumptions applied to our long-term assurance business

The shareholder's interest in the long-term assurance business ('embedded value') is calculated on the basis of a series of economic and actuarial assumptions. Following the acquisition of the business of Scottish Widows, a detailed review of the economic assumptions used in the embedded value calculation was carried out, to ensure that these assumptions remained appropriate for the enlarged life and pensions business in the context of forecast long-term economic trends. As a result of this review certain assumptions were amended, including the risk-adjusted discount rate which was reduced from 10 per cent to 8.5 per cent. The revised assumptions, which were used with effect from 1 January 2000 for Abbey Life and the bancassurance operation of Lloyds TSB Life, resulted in a one-off credit to the profit and loss account of £127 million in 2000. The same assumptions were used for the Scottish Widows business from the date of acquisition.

stakeholder pensions

Stakeholder pensions were introduced from 6 April 2001, with charges on these new products being limited by Government to a maximum of one per cent per annum. In order not to disadvantage existing pensions customers, charges were reduced on our existing book. This had the effect of reducing future cash flows in the Group's embedded value calculation and a one-off charge of £80 million was therefore made to the profit and loss account in 2000.

financial instruments

The Group's activities can be divided into three broad categories: banking and mortgages, insurance and investments, and trading activities.

Banking and mortgage activities represent the most significant element of the Group's business in terms of profit, assets and exposure to risk. These activities are entered into in both the UK and overseas and principally comprise the Group's core business of lending and deposit taking, involving a full range of personal and corporate customers. In entering into this business, the Group's objective is to secure a margin between the interest paid to customers on their deposits and interest received on amounts advanced. In order to do this, more complex financial instruments, such as derivatives, are used as a means of reducing risk by hedging exposures to movements in exchange rates, interest rates or other market variables.

Within its banking activities, the Group has a number of treasury operations that are responsible for utilising surplus funds and meeting funding shortfalls by entering into transactions in the money markets. Portfolios of debt securities and treasury bills are held to provide a source of liquidity; it is the Group's intention to hold these investments until maturity although in certain circumstances they may be disposed of before then where, for example, the need to hold the investment no longer applies. Any profits or losses arising from a sale of this kind are recognised immediately.

Insurance and investment businesses provide general insurance and market savings and investment products both within and outside the banking customer bases. Fund management services are also provided although, whilst involving external clients, this activity is currently dominated by the management of internal group funds.

Trading activities are restricted to a few highly specialist authorised trading centres, the principal one being the Group's Treasury department in London. Most of the Group's trading activity is to meet the requirements of customers for foreign exchange and interest rate products, from which the Group is able to earn a spread on the rates charged. However, interest rate and exchange rate positions are taken out using derivatives (forward foreign exchange contracts, interest rate swaps and forward rate agreements) and on-balance sheet instruments (mainly debt securities). The objective of these positions is to earn a profit from favourable movements in market rates. Accordingly, these transactions are reflected in the accounts at their fair value and gains and losses shown in the profit and loss account as dealing profits.

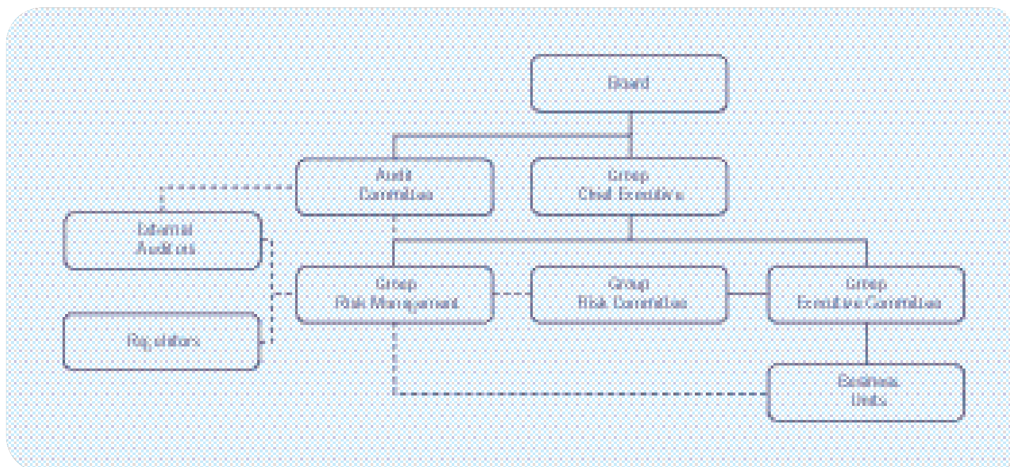
management of risk

The Board is responsible for determining the long-term strategy of the business, the markets in which the Group will operate and the level of risk acceptable to the Group in each area of its business.

The Group Risk Committee, established during 2001, is responsible to the Group Executive Committee for the protection of shareholder value through the assessment and control of the high level risks assumed by the Group, and ensuring that the requisite culture, practices and systems are in place across the Group to meet internal and external obligations. The Group Risk Committee also reviews the allocation and deployment of capital at risk, taking into account the Group's risk appetite.

Responsibility for the implementation of risk policy and for ensuring that there is an effective top level control framework is delegated to the Director of Group Risk Management, who reports to the Group Chief Executive and has access to the Chairman and members of senior management. The Audit Committee and the Board in turn receive regular reports on risk issues prepared by Group Risk Management. The Director of Group Risk Management is also responsible for the provision of independent oversight of management actions which impact upon the risk profile of the Group.

This risk governance structure is illustrated in the following organogram:



The Director of Group Risk Management implements the policies established by the Board through four principal departments: Group Risk, Group Audit, Group Compliance and Sanctioning & Sovereign Risk. Group Risk's responsibilities include credit risk, market risk, operational risk, insurance risk and environmental risk; the department also sets risk policy, develops risk methodology and undertakes risk evaluation and reporting. Group Risk Management is also responsible for leading the work to assess the impact of the draft proposals for the introduction of the new Basel Capital Accord and to prepare the Group for the implementation scheduled for 1 January 2005.

At an operating level, the Group promotes sound internal risk management practices through the directors of its separate business units, who have primary responsibility for measuring, monitoring and controlling the range of portfolio and operating risks within their specific area of accountability. The directors and management of the business units, as the primary risk managers, are responsible for establishing proper control frameworks within their businesses to ensure that the Group's activities are conducted effectively but prudently, and within the parameters defined by Group Risk Management. They are responsible for ensuring that the risks within their business are identified, assessed, controlled and monitored, and that the controls and procedures implemented comply with Group policies and standards, which are extensively documented in rule books and procedures manuals.

Credit risk

Credit risk arises from extending credit in all forms in the Group's banking and trading activities, where there is a possibility that a counterparty may default. The Group has dedicated standards, policies and procedures to control and monitor all such risks.

Group Risk Management's responsibilities in respect of credit risk include the following:

- Formulation of high level credit policies designed to ensure a balanced and managed approach to the identification and mitigation of credit risk. These policies provide a standard framework within which Group businesses structure their individual policies and rules. Group Risk reviews, approves and monitors credit policy documents established for individual businesses.
- Provision of lending guidelines. These define the responsibilities for lending officers and provide a disciplined and focused benchmark for sound credit decisions. Clear guidance is provided on the Group's attitude towards and appetite for credit exposure on different market sectors, industries and products.
- Provision of a Group rating system. All business units are required to operate an authorised rating system that complies with the Group's standard methodology. The Group uses a 'Master Scale' rating structure with nine ratings, each corresponding to a probability of future default.
- Establishment and maintenance of the Group's Large Exposures Policy. Exposure to individual counterparties or groups of counterparties is controlled through a tiered hierarchy of delegated sanctioning authorities. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature of the risk. Regular reports on significant credit exposures are provided to the Group Executive Committee and Board.
- Control of bank exposures. In-house proprietary rating systems are used to approve bank facilities on a Group basis.
- Monitoring of scorecards. The Group utilises statistically-based decisioning techniques (primarily credit scoring and performance scoring) for its main consumer lending portfolios. Authorisations are determined by scorecards tailored to meet the needs of the particular business. Group Risk reviews and monitors new and material changes to scorecards.
- Control of cross-border exposures. Country limits are authorised and managed by a dedicated unit, using an in-house rating system which takes into account economic and political factors.
- Maintenance of a facilities database. Group Risk operates a centralised database of large corporate, sovereign and bank facilities designed to ensure that a consistent aggregation policy is maintained throughout the Group.
- Formulation of concentration limits on certain industries and sectors. Group Risk sets limits and monitors exposures to prevent over-concentration of risk.
- Monitoring and controlling residual value risk exposure. The Group's appetite for such exposure is communicated to the business by a series of time referenced sector caps, ensuring an acceptable distribution of future risk. Methods of mitigating downside risk include obtaining manufacturer's guarantees and deficiency value insurance. For the element of downside risk not covered by such instruments, the need for provisions is regularly reviewed. Appropriate industry-specific information sources are used to assess future values and monitor the risk.
- Portfolio analysis. In conjunction with Group Risk, Group businesses identify and define portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposure. This entails the production and analysis of regular portfolio monitoring reports for review by Group Risk.
- Communication and provision of general guidance on all credit-related risk issues, including regulatory changes and environmental risk policy, to promote consistent and best practice throughout the Group.

Day-to-day credit management and asset quality within each business unit is the primary responsibility of the business unit directors. Each business unit has in place established credit processes involving credit policies, procedures and lending guidelines. Authority to delegate lending discretions within operating divisions rests with officers holding divisional lending delegated authority. All material authorities are advised to Group Risk.

Specialist units are established within Group business units to provide intensive management and control in order to maximise recoveries of doubtful debts.

Regular independent audits of credit processes are undertaken by Group Audit. Such audits include consideration of the completeness and adequacy of credit manuals and lending guidelines, together with an in-depth analysis of a

Credit risk (continued)

representative sample of accounts in the portfolio to assess the quality of the loan book and other exposures. Individual accounts are reviewed to ensure that the facility grade is appropriate, that credit procedures have been properly followed and that, where an account is non-performing, provisions raised are adequate.

Credit risk also arises from the use of derivatives. Note 47a) on pages 80 and 81 shows the total notional principal amount of interest rate, exchange rate and equity contracts outstanding at 31 December 2001. The notional principal amount does not, however, 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. This replacement cost is also shown in note 47a).

To reduce credit risk the Group uses a variety of credit enhancement techiques such as netting and collateralisation, where security is provided against the exposure.

Credit derivatives are a method of transferring credit risk from one counterparty to another and of increasing exposure to selected counterparties. Credit derivatives include credit swaps, credit spread options and credit linked notes. Lloyds TSB has minimal exposure to such instruments.

Market risk in banking operations

Market risk is the risk of losses being incurred as a result of adverse movements in interest or exchange rates or other market variables. It is managed by a variety of different techniques, and strictly controlled within aggregate limits authorised by the Board. The Group's banking activities expose it to the risk of adverse movements in interest rates or exchange rates, with little or no exposure to equity or commodity risks.

Limits to control trading positions and interest rate risk within the wholesale banking book are set by Group Risk up to a total authorised by the Board. A combination of risk measurement techniques are used, including position limits and sensitivity limits. These are supplemented by a range of Value at Risk (VaR) techniques in use in individual businesses, where suitable methodologies have been developed in consultation with Group Risk to meet the specific requirements of each centre. At Group level, global positions are incorporated into a central VaR model, taking into account natural offset positions between different trading centres, and stress tests are carried out to simulate extreme conditions.

Trading activities are restricted to a few highly specialist trading centres, authorised by Group Risk, the principal one being the Group's Treasury department in London. The level of exposure is strictly controlled and monitored within approved limits locally and centrally by Group Risk. Most of the Group's trading activity is undertaken to meet the requirements of customers for foreign exchange and interest rate products. However, some interest rate and exchange rate positions are taken out using derivatives (forward foreign exchange contracts, interest rate swaps and forward rate agreements) and on-balance sheet instruments (mainly debt securities), with the objective of earning a profit from favourable movements in market rates. Accordingly, these transactions are reflected in the accounts at their fair value and gains and losses shown in the profit and loss account as dealing profits. Further details on trading derivatives can be found on page 80.

Various parameters are used to calculate the VaR on a given trading portfolio of positions, thus avoiding undue reliance on a single measure. Based on the commonly quoted 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding three years, during 2001 the VaR on the Group's global trading averaged £1.17 million (2000: £1.28 million) with a maximum of £1.62 million (2000: £1.67 million) and a minimum of £0.78 million (2000: £0.98 million). The figure at 31 December 2001 was £1.62 million (2000: £1.17 million).

Interest rate risk in the wholesale banking books in the UK is managed by Lloyds TSB Group Treasury, and internationally is managed by an authorised local treasury operation in each overseas centre. The levels of exposure within these books are controlled and monitored within approved limits, both locally and centrally by Group Risk. Group Risk issues the limits to the international business units on interest rate gaps or, where more appropriate, VaR. Active management of the book is necessary to meet customer requirements and changing market circumstances.

Structural interest rate risk in the Group's retail portfolios, including mortgages, and in the Group's capital funds, arises from the different repricing characteristics of the Group's banking assets and liabilities and is managed by the Group's Balance Sheet Management (GBSM) department. GBSM reports to an Asset and Liability Committee under

Market risk in banking operations (continued)

the chairmanship of the Group Finance Director; other members include the Director of Group Risk Management and the managing directors of the Group's principal business units. The Group's Board-approved policy is to optimise the stability of future net interest income, which is achieved by entering into hedging transactions using interest rate swaps and other financial instruments.

The simulation models used by GBSM include assumptions about the relationships between customer behaviour and the level of interest rates; the anticipated level of future business is also taken into account. The accuracy of these assumptions will impact the efficiency of hedging transactions. The assumptions are regularly updated and the projected exposure is actively managed in accordance with Lloyds TSB Group's Asset and Liability Committee policy.

The Group's non-trading exposure is summarised in the form of an interest rate repricing table, as set out on page 82. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date. However, the table does not take into account the effect of interest rate options used by the Group to hedge its exposure.

Derivatives are used to meet customers' financial needs, 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 contracts (including interest rate swaps, forward rate agreements and options) and exchange rate contracts (including forward foreign exchange contracts, currency swaps and options). 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.

Market risk in insurance operations

The Group's insurance activities also result in market risk, which can be categorised into two broad types: direct investment market risk on surplus assets held in excess of liabilities; and indirect market risk arising from any mismatch between assets held to back the liabilities themselves.

Direct investment market risk is derived from two portfolios: the surplus in the life businesses; and an investment portfolio within the general insurance business. Investment is undertaken in accordance with Group approved policy.

The surplus in the life businesses exists to provide liquidity and solvency capital. With profits business, in particular, involves guaranteed benefits that create an indirect market risk to the Group. Accordingly, in extreme investment market conditions, the associated surplus could be called upon to support with profits benefits.

Equity derivatives are used by the Group to match equivalent liabilities arising from some of its retail products. Derivatives may also be used for efficient portfolio management purposes in client funds where such activity is in accordance with Group approved policy and the customer mandate.

The general insurance portfolio comprises funds that form the capital and reserves for that business. These reserves are invested in a mixture of assets: cash, bonds and equities.

Under UK GAAP the assets are shown at market value and gains and losses are recognised in the profit and loss account.

Structural foreign exchange risk

Structural foreign exchange risk arises from the Group's investments in its overseas operations. The structural position is managed after having regard to the currency composition of the Group's risk-weighted assets, the objective being to limit the effect of exchange rate movements on the published risk asset ratio.

The Group's structural position at 31 December 2001 is set out on page 83 in note 47d). The position implies that a hypothetical increase of 10 per cent in the value of sterling against all other currencies would lead to a £172 million reduction in reserves. There would be no material impact upon the Group's risk asset ratio.

Liquidity risk

To ensure that each business unit can meet its financial obligations as they fall due, the Group complies with the Financial Services Authority's Sterling Stock Liquidity policy in the UK, with similar liquidity policies in place across all trading centres worldwide. Compliance is monitored by regular liquidity returns to Group Risk.

Liquidity risk (continued)

The sources and maturities of assets and liabilities are closely monitored and diversified to avoid any undue concentration. A substantial proportion of deposits is made up of current and savings accounts which, although repayable on demand, have traditionally formed a stable deposit base.

The Group's significant involvement in the London money market and other financial centres, together with the strength of the Group's earnings and balance sheet, are important factors in assuring the continued availability of wholesale funds at competitive rates.

Operational risk

Operational risk is the exposure to financial or other damage arising through unforeseen events or failure in the Group's operational processes/systems. Examples include inadequate or failed internal controls and procedures, human error, deliberate or malicious acts including fraud, and business interruptions.

Business units have primary responsibility for identifying and managing their operational risks. Internal control techniques to reduce their likelihood or impact include segregation of duties, exception and exposure reporting, business continuity planning, reconciliation, and delegation of authority, and are based on the submission of timely and reliable management reporting. Where appropriate, risk is mitigated by way of insurance with third parties.

Group Risk Management's responsibilities in respect of operational risk are as follows:

Policy & Methodology:

- Formulation of high-level operational risk policies designed to ensure a comprehensive and consistent approach to the identification and management of operational risk. These policies provide a standard framework within which Group businesses structure their individual policies and procedures.
- Development of a standard methodology to ensure consistency in the identification, assessment and management of operational risk. This methodology is being implemented by business units throughout the Group.
- Communication and provision of general guidance on operational risk related issues, including regulatory changes and developments in the measurement and management of operational risk, to promote best practice throughout the Group.

Assurance:

- Approval from a risk perspective of all new products launched throughout the Group, to ensure that the risks associated with them are understood by the business.
- Identification of risk through formal risk reviews, covering specific risks, activities, business sectors or products, and ensuring that prompt and pre-emptive action is taken to address any actual or perceived risks that may emerge, whether specific to the Group or to the industry generally.
- Independent verification by Group Audit of the effectiveness of risk control within business units.

A major cause of operational losses is fraud involving credit and debit cards. In common with the rest of the financial services industry, Lloyds TSB is investing in technology to combat this problem.

Insurance risk

The Group offers insurance products to its customers, and Group Risk actively reviews the extent to which the associated risk is underwritten internally, or reinsured with external underwriters. The risks associated with long term savings, investment and insurance products are also evaluated.

The Financial Services Authority sets down minimum requirements for solvency and reserving for all classes of insurance, which are carefully monitored by the relevant business units within the Group. The retained risk level is carefully controlled and monitored, with close attention being paid to the analysis of underwriting experience, product design, policy wordings, adequacy of reserves, solvency management and regulatory requirements.

Investment strategy is determined by the term and nature of the underwriting liabilities, and asset/liability matching positions are actively monitored. General insurance exposure to accumulations of risk and possible catastrophes is

Insurance risk (continued)

mitigated by reinsurance arrangements which are broadly spread over different reinsurers. Appropriate reinsurance arrangements also apply within the life and pensions businesses.

Compliance risk

The Group's business is regulated overall by the Financial Services Authority (FSA), and additionally by local regulators in offshore and overseas jurisdictions. Each Group business has a nominated individual with 'Compliance Oversight' responsibility under FSA rules. The role of such individuals is to ensure that management have in place within the business a control structure which creates awareness of the rules and regulations to which the Group is subject, and to monitor and report on adherence to these rules and regulations.

All compliance personnel also have a reporting line to Group Compliance, which sets compliance standards across the Group and provides independent reporting and assessment to the Group directors and the Board.

Group Compliance includes a dedicated unit, led by the Group Financial Crime Director, which is responsible for ensuring that the Group has effective processes in place to identify and report on suspicious transactions and customers in support of the world-wide fight against financial crime.

The Group Compliance Director has access to the Chairman, Group Chief Executive and members of senior management.

Corporate social responsibility

Lloyds TSB Group adopts a responsible attitude to social, environmental and ethical (SEE) issues, and publishes a separate annual information pack on its role in the community, its code of business conduct and its environmental performance: 'the community and our business' (see page 85 for details).

The Group has a dedicated environmental risk unit which is responsible for the development of environmental policies and procedures, and provides practical advice and guidance on environmental issues to business units. Significant progress has been made in developing the Group's environmental management system, and this is detailed in the environmental report forming part of 'the community and our business'.

Following the recent publication by the Association of British Insurers of guidelines on the disclosure of information on SEE issues in company annual reports, the Group is reviewing its SEE policies and disclosures.

five year **financial summary**

	2001 £m	2000 £m	1999 £m	1998 £m	1997 £m
Profit and loss account					
Net interest income	**4,944**	4,587	4,783	4,398	4,144
Other operating income	**3,882**	3,937	3,195	2,777	3,247
Total income	**8,826**	8,524	7,978	7,175	7,391
Operating expenses	**(4,324)**	(3,952)	(3,417)	(3,504)	(4,119)
Trading surplus	**4,502**	4,572	4,561	3,671	3,272
General insurance claims	**(174)**	(142)	(169)	(146)	(145)
Provisions	**(807)**	(573)	(622)	(570)	(514)
Income from associated undertakings and joint ventures	**(10)**	3	12	14	23
Profit (loss) on sale and closure of businesses	**39**	–	(126)	84	154
Profit on ordinary activities before tax	**3,550**	3,860	3,656	3,053	2,790
Profit on ordinary activities after tax	**2,579**	2,755	2,545	2,159	2,044
Profit for the year attributable to shareholders	**2,500**	2,706	2,539	2,146	2,030
Economic profit	**1,543**	1,839	1,777	1,424	1,441
Results excluding special items					
Total income excluding special items	**9,544**	8,671	8,022	7,547	7,465
Operating expenses excluding special items	**4,091**	3,764	3,417	3,466	3,768
Operating profit excluding special items	**4,462**	4,195	3,826	3,379	3,061
Special items:					
Short-term fluctuations in investment returns	**(648)**	(94)	58	19	26
Changes in economic assumptions applied to long-term assurance business	**–**	127	–	123	–
Exceptional restructuring costs	**(217)**	(188)	–	(38)	(351)
Abbey National offer costs	**(16)**	–	–	–	–
Pension provisions	**(70)**	(100)	(102)	(400)	(100)
Stakeholder pension related charge	**–**	(80)	–	–	–
Guaranteed annuity provision	**–**	–	–	(114)	–
Profit (loss) on sale and closure of businesses	**39**	–	(126)	84	154
Statutory profit before tax	**3,550**	3,860	3,656	3,053	2,790

Note
Figures for 2000 and earlier years have been restated to reflect the implementation of FRS 12, “Provisions, Contingent Liabilities and Contingent Assets”, FRS 15, “Tangible Fixed Assets”, FRS 18, “Accounting Policies”, and other minor adjustments.

five year **financial summary**

	2001 £m	2000 £m	1999 £m	1998 £m	1997 £m
Balance sheet and capital ratios					
Loans and advances to banks and customers	**138,159**	129,722	119,196	113,706	108,290
Investments	**24,489**	14,861	15,125	13,324	13,426
Other assets	**27,502**	23,445	16,187	17,912	17,041
	190,150	168,028	150,508	144,942	138,757
Long-term assurance assets attributable to policyholders	**46,389**	51,085	26,542	23,692	20,046
Total assets	**236,539**	219,113	177,050	168,634	158,803
Deposits by banks and customers and debt securities in issue	**157,846**	136,623	123,668	119,389	114,284
Other liabilities	**12,890**	13,319	11,485	13,927	13,898
Subordinated liabilities (loan capital)	**7,657**	7,510	6,493	4,021	4,209
Minority interests (equity and non-equity)	**997**	552	33	42	40
Shareholders' funds (equity)	**10,760**	10,024	8,829	7,563	6,326
	190,150	168,028	150,508	144,942	138,757
Long-term assurance liabilities to policyholders	**46,389**	51,085	26,542	23,692	20,046
Total liabilities	**236,539**	219,113	177,050	168,634	158,803
Risk asset ratio : total capital	**9.2%**	9.4%	15.2%	11.4%	10.9%
: tier 1 capital	**8.4%**	8.5%	10.2%	8.8%	8.0%
Share information					
Earnings per share	**45.2p**	49.3p	46.6p	39.7p	38.0p
Dividends per share (net)	**33.7p**	30.6p	26.6p	22.2p	17.2p
Dividend cover (times)	**1.3**	1.6	1.7	1.8	2.2
Market price (year-end)	**746p**	708p	774p	855p	789p
Net assets per share	**191p**	180p	159p	137p	116p
Number of shareholders (thousands)	**981**	1,026	1,024	1,028	1,047
Average shares in issue (millions)	**5,533**	5,487	5,445	5,400	5,341
Performance measures					
Post-tax return on average shareholders' equity	**23.5%**	28.1%	30.0%	29.7%	34.5%
Post-tax return on average assets*	**1.46%**	1.74%	1.72%	1.55%	1.51%
Post-tax return on average risk-weighted assets*	**2.53%**	3.10%	3.04%	2.70%	2.52%
Efficiency ratio	**49.0%**	46.4%	42.8%	48.8%	55.7%

** assets exclude long-term assurance assets attributable to policyholders*

Note
Figures for 2000 and earlier years have been restated to reflect the implementation of FRS 12, "Provisions, Contingent Liabilities and Contingent Assets", FRS 15, "Tangible Fixed Assets", FRS 18, "Accounting Policies", and other minor adjustments.

the board

executive directors

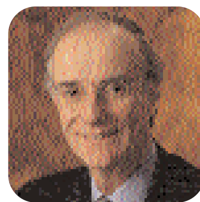
Maarten A van den Bergh◆
Chairman
Joined the Group in 2000 as deputy chairman and was appointed chairman in 2001. Joined the Royal Dutch/Shell Group of companies in 1968 and after a number of senior and general management appointments in that group, became group managing director in 1992. Appointed president of Royal Dutch Petroleum Company and vice chairman of the committee of managing directors of the Royal Dutch/Shell Group in 1998 and continued in these roles until 2000. A non-executive director of Royal Dutch Petroleum Company and BT Group. Aged 59.

Alan E Moore CBE*§
Deputy Chairman
Joined Lloyds Bank International in 1980. Held a number of senior and general management appointments in that company and in Lloyds Bank before becoming a director of Lloyds Bank in 1989 and deputy chief executive and treasurer in 1994. Following the merger with TSB Group in 1995, became deputy group chief executive of Lloyds TSB Group and then deputy chairman in 1998. Joined Glyn Mills & Co in 1953, holding senior appointments there until his secondment, as director general, to the Bahrain Monetary Agency from 1974 to 1979. Aged 65.

Peter B Ellwood CBE
Group Chief Executive
Joined TSB Bank in 1989 as chief executive, retail banking. Appointed a director of TSB Group in 1990 and became group chief executive in 1992. Following the merger with Lloyds Bank in 1995, became deputy group chief executive of Lloyds TSB Group and then group chief executive in 1997. Joined Barclays Bank in 1961 and held a number of senior and general management appointments, including chief executive of Barclaycard from 1985 to 1989. Chairman of the Industrial Society. Former chairman of Visa International. Aged 58.

Michael E Fairey
Deputy Group Chief Executive
Joined TSB Group in 1991 and held a number of senior and general management appointments before being appointed to the board in 1997 and deputy group chief executive in 1998. Joined Barclays Bank in 1967 and held a number of senior and general management appointments, including managing director of Barclays Direct Lending Services from 1990 to 1991. Aged 53.

Michael D Ross CBE
Deputy Group Chief Executive
Joined the board in 2000. Joined Scottish Widows in 1964 and following a number of senior and general management appointments became group chief executive of that company in 1991. Chairman of the Association of British Insurers. Aged 55.



M Kent Atkinson
Group Finance Director
Joined Bank of London & South America in 1964, which became a Lloyds Bank subsidiary in 1971, and held a number of senior and general management appointments, including positions in Latin America and the Middle East, before being appointed to the board in 1997. A non-executive director of Coca-Cola HBC SA. Aged 56.

J Eric Daniels
Group Executive Director, UK Retail Banking
Joined the board in 2001. Served with Citibank from 1975 and held a number of senior and general management appointments in the USA, South America and Europe before becoming chief operating officer of Citibank Consumer Bank in 1998. Following the Citibank/Travelers merger in 1998, he was chairman and chief executive officer of Travelers Life and Annuity until 2000. Chairman and chief executive officer of Zona Financiera from 2000 to 2001. Aged 50.

Archie G Kane
Group Executive Director, IT and Operations
Joined TSB Commercial Holdings in 1986 and held a number of senior and general management appointments in the Group before being appointed to the board in 2000. After some 10 years in the accountancy profession, joined General Telephone & Electronics Corporation in 1980, serving as finance director in the UK from 1983 to 1985. Chairman of the council of the Association for Payment Clearing Services. Aged 49.

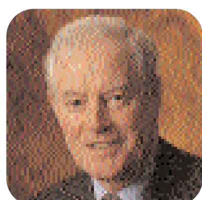
David P Pritchard
Group Executive Director,
Wholesale and International Banking
Joined TSB Group in 1995 as group treasurer. Seconded to the Securities and Investments Board as head of supervision & standards, markets & exchanges, from 1996 to 1998. Appointed to the board in 1998. Held senior and general management appointments with Citicorp from 1978 to 1986 and Royal Bank of Canada from 1986 to 1995. A non-executive director of The London Clearing House. Aged 57.

independent non-executive directors

Ewan Brown CBE FRSE**
Chairman of Lloyds TSB Scotland
A director since 1999. A non-executive director of Lloyds TSB Scotland since 1997. Executive director of Noble Grossart since 1971. Chairman of the court of Heriot-Watt University and a non-executive director of Stagecoach Holdings. Former chairman of Dunedin Income Growth Investment Trust. Aged 59.

A Clive Butler‡§▲
A director of TSB Group since 1993. Joined Unilever in 1970 and following a number of senior and general management appointments was appointed an executive director of Unilever in 1992. Aged 55.

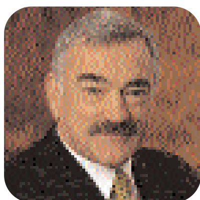
Sheila M Forbes†
A director of TSB Group since 1994. Chairs the board of governors of Thames Valley University and is a civil service commissioner. Head of personnel for Unigate from 1980 to 1988 and personnel director for Storehouse from 1988 to 1992. Director of human resources at Reed Elsevier (UK) from 1992 to 1996. Aged 55.



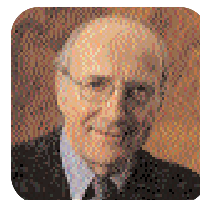
Gavin J N Gemmell CBE*
(from 17 April 2002)
Chairman (designate) of Scottish Widows
Joins the board on 17 April 2002. A non-executive director of Scottish Widows since 1984. Senior partner of Baillie Gifford & Co from 1989 to 2001, having held a number of appointments since joining the firm in 1964. A non-executive director of Scottish Enterprise Edinburgh and Lothian. Aged 60.

Christopher S Gibson-Smith†
A director since 1999. Chairman of National Air Traffic Services and a non-executive director of Powergen. Managing director of BP from 1997 to 2001, having held senior and general management appointments in the UK, USA, Canada and Europe, since joining that company in 1970. Aged 56.

DeAnne S Julius CBE†
Joined the board in 2001. Held a number of senior appointments in the UK and USA with the World Bank, Royal Dutch/Shell Group and British Airways, before membership of the Bank of England Monetary Policy Committee from 1997 to 2001. Chaired HM Treasury's banking services consumer codes review group. A non-executive director of the Bank of England, BP and Serco Group. Aged 52.



Thomas F W McKillop*†
A director since 1999. Joined ICI in 1969 and held a number of senior and general management appointments before the demerger in 1993, when Zeneca was created. Chief executive of Zeneca Pharmaceuticals from 1994 to 1999 and chief executive of AstraZeneca from 1999. Pro-chancellor of Leicester University. Aged 58.



The Earl of Selborne KBE FRS§
A director since 1995, having been a director of Lloyds Bank since 1994. Managing director of The Blackmoor Estate, his family business. Chancellor of Southampton University since 1996. President of the Royal Geographical Society from 1997 to 2000. Aged 61.

Lawrence M Urquhart*
(retiring at the annual general meeting on 17 April 2002)
Chairman of Scottish Widows
Joined the board in 2000. Chairman of BAA and a non-executive director of Imerys SA. Joined Burmah Castrol in 1977 and held a number of senior and general management appointments in that company, including chief executive from 1985 to 1993 and chairman from 1990 to 1998. Former chairman of English China Clays. Aged 66.

Company Secretary
Alastair J Michie FCIS FCIBS

- * Member of the audit committee
- ** Chairman of the audit committee
- † Member of the remuneration committee
- ‡ Chairman of the remuneration committee
- § Member of the nomination committee
- ◆ Chairman of the nomination committee
- ▲ Senior independent director

directors' **report**

results and dividends

The consolidated profit and loss account on page 55 shows a profit attributable to shareholders for the year ended 31 December 2001 of £2,500 million.

An interim dividend of 10.2p per ordinary share was paid on 10 October 2001 and a final dividend of 23.5p per ordinary share will be paid on 1 May 2002. These dividends will absorb £1,872 million.

principal activities

The Company is a holding company and its subsidiaries provide a wide range of banking and financial services through branches and offices in the UK and overseas.

business review and future developments

A review of the business and an indication of future developments are given on pages 2 to 39.

authority to purchase shares

The authority for the Company to purchase, in the market, up to 558 million of its shares, representing some 10 per cent of the issued ordinary share capital, expires at the annual general meeting. It was not used during the year and shareholders will be asked to give a similar authority at the annual general meeting. Details are contained in the accompanying notice of meeting.

directors

Biographical details of directors are shown on pages 42 and 43. Particulars of their emoluments and interests in shares in the Company are given on pages 48 to 51.

Mr Linaker and Sir Brian Pitman retired at the annual general meeting in April 2001 and Mr Holt left the board on 31 August 2001. Mr Urquhart will retire at the annual general meeting in 2002.

Dr Julius and Mr Daniels were appointed directors from 1 October 2001 and 1 November 2001, respectively, and Mr Gemmell will join the board on 17 April 2002. Under the articles of association these new directors offer themselves for election at the annual general meeting.

Mr Fairey, Dr Gibson-Smith, Dr McKillop and The Earl of Selborne retire by rotation at the annual general meeting and offer themselves for re-election.

No director had a material interest at any time during the year in any contract of significance with the Company or its subsidiaries.

employees

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

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

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

Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in the Group.

donations

The profit and loss account includes a charge for charitable donations totalling £36,747,000 (2000: £34,790,000), including £36,376,667 (2000: £34,483,333) under deeds of covenant to the four Lloyds TSB Foundations, which will be paid during 2002. No donations were made to political parties.

policy and practice on payment of creditors

The Company follows 'The Better Payment Practice Code' published by the Department of Trade and Industry regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from the address shown on page 85.

The Company's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated. It is the policy of the Company to abide by the agreed terms of payment, provided the supplier performs according to the terms of the contract.

As the Company owed no amounts to trade creditors at 31 December 2001, the number of days required to be shown in this report, to comply with the provisions of the Companies Act 1985, is nil. The equivalent figure for the Lloyds TSB Group in the UK is 27. This bears the same proportion to the number of days in the year as the aggregate of the amounts owed to trade creditors at 31 December 2001 bears to the aggregate of the amounts invoiced by suppliers during the year.

auditors

Resolutions concerning the re-appointment of PricewaterhouseCoopers as auditors and authorising the directors to set their remuneration will be proposed at the annual general meeting.

On behalf of the board

A J Michie
Secretary

14 February 2002

directors' **remuneration**

the remuneration committee

The remuneration committee, comprising Mr Butler (chairman), Miss Forbes, Dr Gibson-Smith, Dr Julius and Dr McKillop, makes recommendations to the board on the framework of executive directors' remuneration and its cost, and determines, on the board's behalf, specific remuneration packages for each of the chairman, the deputy chairman and the executive directors. Additionally, all the non-executive directors receive the minutes of remuneration committee meetings and have the opportunity to comment and have their views taken into account before the committee's decisions are implemented.

executive directors' remuneration policy

The Group aims to ensure that the executive directors' remuneration arrangements, in line with the Group's overall practice on pay and benefits, are competitive and designed to attract, retain and motivate executive directors of the highest calibre, who are expected to perform to the highest standards. Account is taken of information, from internal and independent sources, on the remuneration for comparable positions in a wide range of FTSE 100 companies. The strategy for executive pay is, generally, for basic salaries to reflect the relevant market median, and total direct compensation (basic salary, annual incentives and the value of long-term incentives) to be at the upper quartile of the market place, provided that performance justifies the amount.

The government recently announced that it intended to legislate to require companies to provide shareholders with more detailed information on directors' remuneration and to put an annual resolution to shareholders on the directors' remuneration report. Following that announcement, the Department of Trade and Industry published a consultative document on the subject at the end of December 2001, inviting comments by the middle of March 2002.

The board considered whether to invite shareholders to vote on the directors' remuneration policy, or report, at the annual general meeting in 2002. On the recommendation of the remuneration committee, the board decided not to do so, concluding that, as there had been no change in the directors' remuneration policy during the year, it would be appropriate to await the outcome of the DTI consultation and the clarification which the proposed legislation would provide.

the reward package

Each year, with the help of external management consultants, the total remuneration package is reviewed, and in 2001 Hay Management Consultants were commissioned by the remuneration committee to conduct the review.

In 2001 the package for executive directors comprised the following elements:

Basic salary

The aim is to ensure that the responsibilities of the role are reflected in the salary and that salaries are competitively set in relation to other comparable companies.

Annual incentive

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

The group chief executive has a maximum incentive opportunity of 100 per cent of his salary, and each of the other executive directors can earn an incentive equal to 75 per cent of their salary. These awards are based on group performance, and for 2001 included the attainment of predetermined targets relating to revenue, business as usual operating profit and economic profit.

The remuneration committee reviewed the attainment of targets and agreed the incentive payments.

Medium-term incentive plan

In April 2000, shareholders approved the introduction of a medium-term incentive plan, which gives executive directors serving at that time the opportunity of an award, deferred until after the end of 2002 and which is subject to two performance targets, based on the efficiency ratio and return on equity. For the group chief executive the maximum award will be equal to 50 per cent of aggregate basic salary for the years 2000-2002 and for other executive directors, the maximum award will be equal to 25 per cent of aggregate basic salary for these three years.

The two minimum performance targets are a reduction in the Group's efficiency ratio to 37 per cent by the end of 2002 and a return on equity of 28 per cent by the end of 2002. No payment will be made under the plan unless both these minimum targets are met.

For the year 2001, the Group's efficiency ratio was 49.0 per cent and return on equity was 23.5 per cent.

Long-term rewards

The Group is committed to the governing objective of maximising shareholder value over time. The board believes that the executive share option schemes for senior executives, approved by the shareholders at the annual general meeting in 1997 and amended at the annual general meeting in 2001, provide an effective method of giving executives the incentive to achieve that objective.

In 2001 options were granted to executive directors and senior executives within the scheme limits. These limits relate to the number of shares under option and the price payable on the exercise of options. The maximum limit for the grant of options to an executive director in any one year would be equal to one and a half times annual basic salary multiplied by 3.5. However, the full grant of options will only become exercisable if Lloyds TSB is ranked first against its comparator group, and will be reduced if below this level. The following table illustrates the percentage of the original grant to an executive director that will vest at each of the positions against the comparator group. Performance conditions are set when the grant of options is made, and these options cannot normally be exercised unless the conditions have been met. To meet the performance conditions, the company's ranking, based on total shareholder return (calculated by reference to both dividends and growth in share price) over the relevant (three year) period, against a comparator group of sixteen companies, must be at least ninth. At end of 2001 Lloyds TSB Group was ranked sixth for the year.

Ranking position against comparator group	% of option which may be exercised
1	100%
2	86%
3	71%
4	57%
5	43%
6	29%
7	23%
8	17%
9	14%
10 or below	Nil – options not exercisable

Share retention plan

During the year, a share retention plan was adopted, specifically to facilitate the recruitment of Mr Daniels, who was based in the USA, as part of the remuneration package considered necessary to attract him to the UK. He is the only participant in the plan and he became eligible to participate in it when he joined the company on 1 November 2001. On 2 November 2001, an option was granted to him under the plan to acquire 216,763 ordinary shares in the company (with a value of £1.5 million at the date of grant) for a total price of £1. No further options may be granted to him under the plan.

No new shares will be issued to satisfy the option.

The option is designed to encourage him to remain with the company and, accordingly, it will normally become exercisable only if he remains an employee, and has not given notice of resignation, on 31 December 2004, or if he ceases to be an employee before that date in certain circumstances described in his service agreement, in which case it will be exercisable for six months and then lapse. Briefly, these include the following:

- If he were to be entitled to terminate his service agreement without notice by reason of his employer's conduct.
- If he were to be removed as a director or employee otherwise than in accordance with that agreement.
- If there were to be any material diminution of his duties.
- If, within 18 months of his employment, there were to be a change of circumstances of the company such that there was, in his reasonable judgement, a material and adverse effect on his prospects or a material diminution of his status.

The option may also be exercisable on a takeover or reconstruction of the company.

The option will lapse if Mr Daniels dies or ceases to be an employee, or gives notice of resignation, before 31 December 2004, except in the circumstances described above.

The number of shares may be adjusted by the board on certain variations in the share capital of the company.

The benefits conferred by the option are not pensionable and the option is not transferable.

Any change to Mr Daniels' rights in the event of a variation of share capital which would be to his advantage could not generally be made without shareholder approval.

Other share plans

The executive directors may participate in the staff profit sharing and 'sharesave' schemes, which were approved by shareholders, on the same basis as other employees.

Pensions

Executive directors are, like most other employees, entitled to pensions based on salary and length of service with the Group, with a maximum pension of two thirds of final salary.

service agreements

Mr Atkinson, Mr Ellwood, Mr Fairey, Mr Kane and Mr Pritchard each has a service agreement which the company may terminate by giving one year's notice. In connection with the arrangements for the transfer of the business of Scottish Widows to the Group in March 2000, Mr Ross's service agreement provided for two years' notice for the first two years. After March 2002, the notice period will decrease by one month for each month of service. In March 2003, therefore, Mr Ross's agreement will provide for one year's notice. To facilitate Mr Daniels' recruitment, his service agreement provides for two years' notice for the first eighteen months: after that, the notice

period reduces to one year. None of the other directors has a service agreement with a notice period of one year or more.

The remuneration committee has considered the provisions of the UK listing authority's corporate governance code relating to compensation in the event of early termination of directors' service agreements and a departing director's duty to mitigate loss. The committee reviewed the wording of the executive directors' agreements and felt that as the notice period did not exceed one year, with the exception of Mr Ross and Mr Daniels as mentioned above, there was no need to provide explicitly for compensation payments on early termination.

directors' emoluments

	Salaries/fees £000	Other benefits £000	Performance-related payments £000	Profit sharing £000	2001 Total £000	2000 £000
Current directors who served during 2001:						
M K Atkinson	355	16	185	32	588	509
Ewan Brown	59				59	45
A C Butler	40				40	33
J E Daniels	75	117			192	–
P B Ellwood	600	23	324	54	1,001	856
M E Fairey	415	123	216	37	791	596
S M Forbes	38				38	34
C S Gibson-Smith	38				38	30
D S Julius	9				9	–
A G Kane	330	17	171	30	548	474
T F W McKillop	45				45	33
A E Moore	200	11		18	229	216
D P Pritchard	355	16	185	32	588	496
M D Ross	395	15	205	35	650	468
Lord Selborne	43				43	42
L M Urquhart	93				93	70
M A van den Bergh	355	15		36	406	68
Former directors who served during 2001:						
Dennis Holt	220	7			227	428
L E Linaker	12				12	36
Sir Brian Pitman	120	21		11	152	488
Former directors who served during 2000						126
	3,797	381	1,286	285	5,749	5,048

'Other benefits' include the use of a car, private medical insurance and life insurance cover. Allowances for relocation, housing and legal advice arising from Mr Daniels' service agreement, and an additional payment in respect of the contribution to the separate fund relating to Mr Fairey's pension, are also included. The separate fund which was mentioned in previous annual reports, was established to cover pension obligations of those who joined the Group after 1 June 1989 and who are subject to the Inland Revenue earnings cap relating to pensions, introduced by the Finance Act 1989.

The total for the highest paid director (Mr Fairey), including the gain of £882,000 on the exercise of share options, mentioned in the table on page 50, was £1,673,000. (The total for the highest paid director in 2000 (Mr Ellwood) was £856,000). Gains on the exercise of share options arise from increases in the share price since the options were granted. Shareholders who held shares for the same periods would have gained similarly from these increases.

directors' pensions

Pension benefits earned by the directors:

	(a) Additional pension earned (excluding inflation) during the year ended 31 December 2001 £	(b) Increase in transfer value (excluding inflation) £	(c) Accrued pension entitlement at 31 December 2001 £
M K Atkinson	**27,406**	**416,704**	**227,274**
J E Daniels	**23,750**	**312,504**	**23,750**
P B Ellwood	**39,564**	**698,877**	**336,441**
M E Fairey	**19,888**	**291,267**	**127,183**
Dennis Holt	**19,721**	**256,671**	**189,541**
A G Kane	**18,608**	**235,895**	**118,599**
D P Pritchard	**12,234**	**207,385**	**30,582**
M D Ross	**27,615**	**401,111**	**245,229**

Column (a) above is the increase in pension built up during the year. It recognises (i) the accrual rate for the additional service based on the pensionable salary in force at the year end and (ii) the effect of pay changes in 'real' (inflation adjusted) terms on the pension already earned at the start of the year.

Column (b) is the additional capital value of column (a) which would arise if the pension were to be transferred to another pension scheme on the director's leaving the company, based on factors supplied by the actuary of the relevant Group pension scheme in accordance with actuarial guidance note GN11, less (where paid) the director's contributions.

Column (c) is the aggregate pension entitlement based on pensionable service with the company to 31 December 2001 but payable at normal retirement age.

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

The pension provisions in Mr Pritchard's service agreement have been changed, with effect from 1 January 2000, to defined benefit arrangements. He therefore waived entitlement to the £63,045 allocation to the defined contribution section of the separate fund mentioned in last year's annual report.

directors’ interests

The directors’ interests, all beneficial, in shares in Lloyds TSB Group were:

Shares	At 31 December 2001	At 1 January 2001 (or date of appointment if later)
M K Atkinson	**124,815**	31,077
Ewan Brown	**3,402**	3,274
A C Butler	**2,000**	2,000
J E Daniels	**1,000**	–
P B Ellwood	**178,751**	177,501
M E Fairey	**74,158**	72,218
S M Forbes	**2,000**	2,000
C S Gibson-Smith	**3,151**	3,151
D S Julius	**2,000**	–
A G Kane	**80,120**	78,865
T F W McKillop	**1,000**	1,000
A E Moore	**1,107,396**	1,043,196
D P Pritchard	**3,367**	2,151
M D Ross	**2,500**	2,500
Lord Selborne	**3,372**	3,372
L M Urquhart	**2,226**	2,124
M A van den Bergh	**4,000**	4,000

Options to acquire shares:		At 1 January 2001 (or date of appointment if later)	Granted during the year	Exercised during the year	At 31 December 2001	Weighted average exercise price at 31 December 2001	Exercise price of share options granted or exercised	Market price at date of exercise	Amount of gain on exercise** 2001 £000	2000 £000
M K Atkinson	Exercisable	253,056			**147,600**	**344p**				
	Not exercisable	183,377			**345,155**	**710p**				
			38,583				**655p**			
			127,131				**733p**			
			1,245				**591p**			
				54,080			**129.81p**	**664p**	**289**	
				27,040			**137.94p**	**664p**	**142**	
				16,224			**137.2p**	**664p**	**85**	
				8,112			**197.49p**	**664p**	**38**	
				5,181			**253p**	**706p**	**23**	
J E Daniels	Exercisable	–			**–**					
	Not exercisable	–	**907,780**		**907,780**	**694p**	**694p**			
P B Ellwood*	Exercisable	321,340			**321,340**	**358p**				
	Not exercisable	311,224			**441,725**	**696p**				
			130,501				**655p**			
M E Fairey*	Exercisable	224,556			**54,000**	**510p**				
	Not exercisable	203,253			**394,138**	**709p**				
			42,884				**655p**			
			148,618				**733p**			
				138,556			**242.5p**	**717p**	**754**	
				32,000			**321p**	**717p**	**127**	
				617			**632p**	**730.5p**	**1**	
A G Kane*	Exercisable	171,547			**171,547**	**312p**				
	Not exercisable	157,784			**310,721**	**715p**				
			34,759				**655p**			
			118,178				**733p**			20
A E Moore	Exercisable	59,439			**–**					
	Not exercisable	3,545			**–**					
				3,545			**253p**	**731p**	**17**	
				59,439			**250.37p**	**694p**	**264**	
D P Pritchard	Exercisable	–			**–**					
	Not exercisable	176,591			**340,096**	**707p**				
			36,374				**655p**			
			127,131				**733p**			
M D Ross	Exercisable	–			**–**					
	Not exercisable	268,941			**440,549**	**615p**				
			30,152				**655p**			
			141,456				**733p**			
Gain made by Dennis Holt, who left the board on 31 August 2001									**53**	7
									1,793	27
Share retention plan										
J E Daniels	Not exercisable	–	**216,763**	**–**	**216,763**	(see page 47)				

Options were not exercisable because they had not been held for the period required by the relevant scheme or the performance conditions had not been met.

directors' interests (continued)

Options to acquire shares (continued)

Options may be exercised between 2002 and 2011.

* These directors will receive additional Lloyds TSB Group shares on exercising share options held on 28 December 1995. These shares will compensate them for the special dividend of 68.3p per share which was paid to former TSB Group shareholders in 1996 following the merger with Lloyds Bank, but which was not paid to optionholders. In that regard Mr Fairey received 13,511 additional shares when he exercised the 138,556 share options shown above. Following that exercise, Mr Fairey no longer held any share options to which these arrangements apply.

** This is the difference between the market price of the shares on the day on which the share option was exercised and the price paid for the shares, and includes the value of shares issued to compensate directors for the special dividend mentioned above.

The market price for a share in the Company at 31 December 2001 was 746p. The range of prices between 1 January 2001 and 31 December 2001 was 590p to 772p.

None of the other directors at 31 December 2001 had options to acquire shares in the Company or its subsidiaries.

Scottish Widows loan capital

At the end of the year, Mr Ross had an interest in £43,194 of Scottish Widows Group Limited floating rate unsecured loan notes 2008 (2000: £57,394).

Non-beneficial interests

Directors had non-beneficial interests as follows:

1. Mr Atkinson, Mr Daniels, Mr Ellwood, Mr Fairey, Mr Kane, Mr Moore, Mr Pritchard, Mr Ross and Mr van den Bergh together with some 73,000 other employees, were potential beneficiaries in the 2,417,245 and 1,952,179 shares held at the end of the year by the Lloyds TSB qualifying employee share ownership trust and the Lloyds TSB Group employee share ownership trust, respectively. 749,896 and 3,100,000 shares, respectively, were held by these trusts at the beginning of the year. These holdings were 1,719,373 and 1,939,013, respectively, on 14 February 2002.
In addition, the TSB Group Employee Trust held 66,536 shares at the beginning of the year and none at the end of the year.
2. At the beginning and end of the year, Mr Ellwood also had a non-beneficial interest in 7,000 shares held in another trust.

None of those who were directors at the end of the year had any other interest in the capital of the Company or its subsidiaries and there were no changes in their beneficial interests between 31 December 2001 and 14 February 2002. The register of directors' interests, which is open to inspection, contains full particulars of directors' shareholdings and options to acquire shares in the Company.

corporate **governance**

The UK listing authority's rules require companies to make statements on corporate governance in their annual reports. The following comments are, therefore, included to comply with these rules.

corporate governance principles

The board considers that good governance is central to achieving the Group's governing objective of maximising shareholder value. That has been uppermost in directors' minds when applying the governance principles contained in the code annexed to the UK listing authority's listing rules.

The following remarks demonstrate how the board has applied these principles.

The information on pages 42 and 43 shows that the Company is led and controlled by a board comprising executive and non-executive directors with wide experience. The appointment of directors is considered by the board and, following the provisions in the articles of association, they must retire by rotation, and may stand for re-election by the shareholders, at least every three years.

The board meets eleven times a year and a programme is prepared and agreed each year, which ensures that the directors are able regularly to review corporate strategy and the operations and results of the business units in the Group and to discharge their other duties. The roles of the chairman, the group chief executive and the board and its governance arrangements are reviewed annually.

The board has a chairman's committee, comprising the chairman, the deputy chairman, the group chief executive and his deputy. The chairman's committee meets to discuss current issues and strategy, examine and test proposals and prepare for board meetings. It also has power to deal with routine matters between board meetings.

The board has audit, nomination and remuneration committees which comply with the provisions of the code.

Information about directors' remuneration is given in the directors' remuneration report on pages 46 to 51 and details of how the board reviews financial and operational controls and risk management generally are shown on page 53 and in the financial review on pages 10 to 39.

The chairman, the group chief executive and the group finance director have meetings with representatives of institutional shareholders and all shareholders are encouraged to participate in the Company's annual general meeting.

compliance with the code

The directors believe that the Company complies with the provisions of the code and that it has complied throughout the year with the provisions where the requirements are of a continuing nature.

directors' responsibilities

The directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the year and of the profit or loss for the year. Following discussions with the auditors, the directors consider that in preparing the financial statements on pages 55 to 84, the Company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider applicable have been followed.

The directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

going concern

The directors are satisfied that the Company and the Group have adequate resources to continue to operate for the foreseeable future and are financially sound. For this reason, they continue to adopt the going concern basis in preparing the accounts.

internal control

The board of directors is responsible for the Group's system of internal control, which is designed to ensure effective and efficient operations, internal control, including financial reporting, and compliance with laws and regulations. It should be noted, however, that such a system is designed to manage, rather than eliminate the risk of failure to achieve business objectives. In establishing and reviewing the system of internal control the directors have regard to the materiality of relevant risks, the likelihood of a loss being incurred and the costs of control. It follows, therefore, that the system of internal control can only provide reasonable but not absolute assurance against the risk of material loss.

The directors and senior management of the Group are committed to maintaining a control-conscious culture across all areas of operation. This is communicated to all employees by way of procedures manuals and regular management briefings. Key business risks are identified, and these are controlled by means of procedures such as physical controls, credit, trading and other authorisation limits and segregation of duties. There are well established budgeting and forecasting procedures in place and reports are presented regularly to the board detailing the results of each principal business unit, variances against budget and prior year, and other performance data. Internal controls contain procedures which assist the board in identifying new and emerging risks.

The effectiveness of the internal control system is reviewed regularly by the board and the audit committee, which also receives reports of reviews undertaken around the Group by the Group's risk management function, including Group Audit and Group Compliance. The audit committee also receives reports from the Company's auditors, PricewaterhouseCoopers, (which include details of significant internal control matters that they have identified) and has a discussion with the auditors at least once a year without executives present, to ensure that there are no unresolved issues of concern.

independent auditors’ **report**

to the members of Lloyds TSB Group plc

We have audited the financial statements which comprise the consolidated profit and loss account, the consolidated balance sheet, the company balance sheet, the consolidated cash flow statement, the statement of total recognised gains and losses and the related notes which have been prepared under the accounting policies set out on pages 61 to 63 and the directors’ remuneration disclosures on pages 48 to 51.

respective responsibilities of directors and auditors

The directors are responsible for preparing the annual report. As described on page 52 this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom Law and Accounting Standards. Our responsibilities, as independent auditors, are established in the United Kingdom by legal and regulatory requirements, the Auditing Standards issued by the Auditing Practices Board and the Listing Rules of the Financial Services Authority.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the United Kingdom Companies Act 1985. We also report to you if, in our opinion, the directors’ report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors’ remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the directors’ report, the chairman’s statement, the financial review and the corporate governance statement.

We review whether the corporate governance statement on pages 52 and 53 reflects the Company’s compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the board’s statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Company’s or Group’s corporate governance procedures or its risk and control procedures.

basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company’s and the Group’s circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2001 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
Southampton

14 February 2002

consolidated
profit and loss account

for the year ended 31 December 2001

	Note	**2001 £ million**	2000* £ million
Interest receivable:			
Interest receivable and similar income arising from debt securities		**530**	443
Other interest receivable and similar income		**10,834**	10,611
Interest payable		**6,420**	6,467
Net interest income		**4,944**	4,587
Other income			
Fees and commissions receivable		**2,922**	2,768
Fees and commissions payable		**(602)**	(479)
Dealing profits (before expenses)	3	**233**	198
Income from long-term assurance business	30	**193**	615
General insurance premium income		**428**	399
Other operating income		**708**	436
		3,882	3,937
Total income		**8,826**	8,524
Operating expenses			
Administrative expenses	4	**3,557**	3,378
Exceptional restructuring costs	5	**217**	188
Total administrative expenses		**3,774**	3,566
Depreciation	24	**511**	364
Amortisation of goodwill	23	**39**	22
Depreciation and amortisation		**550**	386
Total operating expenses		**4,324**	3,952
Trading surplus		**4,502**	4,572
General insurance claims		**174**	142
Provisions for bad and doubtful debts	16		
Specific		**736**	547
General		**11**	(6)
		747	541
Amounts written off fixed asset investments	6	**60**	32
Operating profit		**3,521**	3,857
Income from associated undertakings and joint ventures	21	**(10)**	3
Profit on sale of businesses	7	**39**	–
Profit on ordinary activities before tax	8	**3,550**	3,860
Tax on profit on ordinary activities	9	**971**	1,105
Profit on ordinary activities after tax		**2,579**	2,755
Minority interests: equity		**17**	13
: non-equity	41	**62**	36
Profit for the year attributable to shareholders	10	**2,500**	2,706
Dividends	11	**1,872**	1,683
Retained profit	43	**628**	1,023
Earnings per share	12	**45.2p**	49.3p
Diluted earnings per share	12	**44.8p**	48.8p

** restated (see note 1)*

consolidated **balance sheet**

at 31 December 2001

	Note	**2001 £ million**	2000* £ million
Assets			
Cash and balances at central banks		**1,240**	1,027
Items in course of collection from banks		**1,664**	1,533
Treasury bills and other eligible bills	13	**4,412**	1,709
Loans and advances to banks	14	**15,224**	15,290
Loans and advances to customers		**123,059**	114,832
Non-returnable finance		**(124)**	(400)
	15	**122,935**	114,432
Debt securities	18	**24,225**	14,605
Equity shares	19	**225**	247
Interests in associated undertakings and joint ventures	21		
– share of gross assets		**281**	14
– share of gross liabilities		**(242)**	(5)
		39	9
Intangible fixed assets	23	**2,566**	2,599
Tangible fixed assets	24	**3,365**	3,037
Own shares	27	**23**	28
Other assets	28	**4,468**	3,998
Prepayments and accrued income	29	**3,190**	2,965
Long-term assurance business attributable to the shareholder	30	**6,574**	6,549
		190,150	168,028
Long-term assurance assets attributable to policyholders	30	**46,389**	51,085
Total assets		**236,539**	219,113

** restated (see note 1)*

The directors approved the accounts on 14 February 2002.

M A van den Bergh
Chairman

P B Ellwood CBE
Group Chief Executive

M K Atkinson
Group Finance Director

consolidated **balance sheet**

	Note	2001 £ million	2000* £ million
Liabilities			
Deposits by banks	32	**24,310**	16,735
Customer accounts	33	**109,116**	101,989
Items in course of transmission to banks		**534**	420
Debt securities in issue	34	**24,420**	17,899
Other liabilities	36	**6,673**	6,600
Accruals and deferred income	37	**3,563**	4,174
Provisions for liabilities and charges:			
Deferred tax	38	**1,719**	1,683
Other provisions for liabilities and charges	39	**401**	442
Subordinated liabilities:			
Undated loan capital	40	**3,651**	3,391
Dated loan capital	40	**4,006**	4,119
Minority interests:			
Equity		**37**	37
Non-equity	41	**960**	515
		997	552
Called-up share capital	42	**1,411**	1,396
Share premium account	43	**959**	595
Merger reserve	43	**343**	343
Profit and loss account	43	**8,047**	7,690
Shareholders' funds (equity)		**10,760**	10,024
		190,150	168,028
Long-term assurance liabilities to policyholders		**46,389**	51,085
Total liabilities		**236,539**	219,113
Memorandum items	46		
Contingent liabilities:			
Acceptances and endorsements		**2,243**	357
Guarantees and assets pledged as collateral security		**3,789**	3,249
Other contingent liabilities		**1,931**	1,541
		7,963	5,147
Commitments:			
Commitments arising out of sale and option to resell transactions		**–**	3
Other commitments		**53,342**	42,586
		53,342	42,589

** restated (see note 1)*

company
balance sheet

at 31 December 2001

	Note	2001 £ million	2000 £ million
Fixed assets			
Investments			
Shares in group undertakings	22	**11,960**	11,152
Loans to group undertakings	22	**759**	759
Own shares	27	**23**	24
		12,742	11,935
Current assets			
Debtors falling due within one year			
Amounts owed by group undertakings		**1,369**	1,233
Other debtors		**47**	42
Tax recoverable		**29**	16
Cash balances with group undertakings		**114**	66
		1,559	1,357
Current liabilities			
Amounts falling due within one year			
Short-term borrowings	35	**–**	1
Amounts owed to group undertakings		**1,760**	1,811
Other creditors		**62**	62
Dividend payable		**1,306**	1,172
		3,128	3,046
Net current liabilities		**(1,569)**	(1,689)
Total assets less current liabilities		**11,173**	10,246
Creditors			
Amounts falling due after more than one year			
Dated loan capital	40	**413**	512
Net assets		**10,760**	9,734
Capital and reserves			
Called-up share capital	42	**1,411**	1,396
Share premium account	43	**959**	595
Revaluation reserve	43	**5,894**	5,086
Profit and loss account	43	**2,496**	2,657
Shareholders' funds (equity)		**10,760**	9,734

The directors approved the accounts on 14 February 2002.

M A van den Bergh
Chairman

P B Ellwood CBE
Group Chief Executive

M K Atkinson
Group Finance Director

other **statements**

statement of total recognised gains and losses

for the year ended 31 December 2001

	2001 £ million	2000* £ million
Profit attributable to shareholders	**2,500**	2,706
Currency translation differences on foreign currency net investments	**(86)**	(11)
Total recognised gains and losses relating to the year	**2,414**	2,695
Prior year adjustment in respect of the adoption of FRS 18 (note 1)	**248**	–
Prior year adjustment in respect of the adoption of FRS 15	**–**	(112)
Total gains and losses recognised during the year	**2,662**	2,583

** restated (see note 1)*

historical cost profits and losses

for the year ended 31 December 2001

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 shareholders' funds

for the year ended 31 December 2001

	2001 £ million	2000* £ million
Profit attributable to shareholders	**2,500**	2,706
Dividends	**(1,872)**	(1,683)
Retained profit	**628**	1,023
Currency translation differences on foreign currency net investments	**(86)**	(11)
Issue of shares	**194**	74
Goodwill written back on sale and closure of businesses	**–**	109
Net increase in shareholders' funds	**736**	1,195
Shareholders' funds at beginning of year	**10,024**	8,581
Prior year adjustment (note 1)	**–**	248
Shareholders' funds at end of year	**10,760**	10,024

** restated (see note 1)*

consolidated
cash flow statement

for the year ended 31 December 2001

	2001 £ million	2000* £ million
Net cash inflow from operating activities (note 49a)	**9,927**	7,474
Dividends received from associated undertakings	**2**	2
Returns on investments and servicing of finance:		
Dividends paid to equity minority interests	**(17)**	(12)
Payments made to non-equity minority interests	**(62)**	(36)
Interest paid on subordinated liabilities (loan capital)	**(492)**	(442)
Interest element of finance lease rental payments	**(1)**	(1)
Net cash outflow from returns on investments and servicing of finance	**(572)**	(491)
Taxation:		
UK corporation tax	**(682)**	(723)
Overseas tax	**(147)**	(141)
Total taxation	**(829)**	(864)
Capital expenditure and financial investment:		
Additions to fixed asset investments	**(47,049)**	(23,564)
Disposals of fixed asset investments	**40,530**	24,850
Additions to tangible fixed assets	**(1,157)**	(1,006)
Disposals of tangible fixed assets	**285**	78
Capital injection to life fund	**(100)**	–
Net cash (outflow) inflow from capital expenditure and financial investment	**(7,491)**	358
Acquisitions and disposals:		
Additions to interests in joint ventures	**(44)**	–
Acquisition of group undertakings (note 49e)	**(180)**	(5,110)
Disposal of group undertakings and businesses (note 49g)	**40**	83
Net cash outflow from acquisitions and disposals	**(184)**	(5,027)
Equity dividends paid	**(1,738)**	(1,522)
Net cash outflow before financing	**(885)**	(70)
Financing:		
Issue of subordinated liabilities (loan capital)	**286**	952
Issue of capital securities by subsidiary undertakings	**456**	509
Issue of ordinary share capital net of £185 million (2000: £124 million) contribution to the QUEST (note 27)	**194**	74
Repayments of subordinated liabilities (loan capital)	**(131)**	(55)
Capital element of finance lease rental payments	**(20)**	(4)
Net cash inflow from financing	**785**	1,476
(Decrease) increase in cash (note 49c)	**(100)**	1,406

** restated (see note 1)*

notes to **the accounts**

1 Accounting policies

Accounting policies are unchanged from 2000, except that the Group has implemented the requirements of Financial Reporting Standard 18 'Accounting Policies'. On implementation of this new standard, the Group has taken the opportunity to review the appropriateness of accounting policies and the following change has been made as a result. Debt securities acquired in exchange for advances to countries experiencing payment difficulties which are not (nor due to be) collateralised by US Treasury securities ('uncollateralised bonds') were, like the original debt, previously included in loans and advances, at their written down value at the date of exchange as adjusted for any subsequent movements in bad debt provisions. This treatment is no longer considered to be the most appropriate and the uncollateralised bonds have been reclassified as debt securities where they are carried at an amount based on the market value at the date of the original exchange as adjusted for the amortisation of the discount on acquisition. A prior year adjustment, increasing reserves by £248 million, has been made to reflect the revised policy.

The effect of this change on the profit and loss account for the year ended 31 December 2001 has been to increase other operating income by £77 million (2000: £58 million), increase the charge for bad and doubtful debts by £84 million (2000: £66 million), increase amounts written off fixed asset investments by £38 million (2000: £18 million) and to reduce profit before tax by £45 million (2000: £26 million). Loans and advances have been reduced by £294 million (2000: £312 million), debt securities have increased by £657 million (2000: £723 million) and shareholders' funds have increased by £254 million (2000: £287 million). In addition, certain sundry assets and liabilities have been reclassified. 2000 comparative figures have been restated.

During the year the Group has also adopted Financial Reporting Standard 17 'Retirement Benefits'. In accordance with the transitional arrangements of the standard in accounts for the year ended 31 December 2001, supplementary disclosures only are required and these are set out in note 45c. The Group has also implemented the requirements of the British Bankers' Association's revised Statement of Recommended Practice on Derivatives, although the effect has not been significant.

In addition, the Group has implemented the requirements of the Urgent Issues Task Force's Abstract 32 'Employee benefit trusts and other intermediate payment arrangements'. This has had no effect on the consolidated Group figures, but the balances relating to the Lloyds TSB Group Qualifying Share Ownership Trust have now been included on the Company's balance sheet. Due to the immateriality of the amounts involved, comparatives for 2000 have not been restated.

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 accounts of the Company are prepared under the historical cost convention as modified by the revaluation of shares in group undertakings (see h), in compliance with Section 226, Schedule 4 and other requirements of the Companies Act 1985 and in accordance with applicable accounting standards and pronouncements of the Urgent Issues Task Force.

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. 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, 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 stability of the industry; the typical lifespans of the products; the extent to which the acquisition overcomes market entry barriers; and the expected future impact of competition on the business.

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 the goodwill is evaluated by comparing the present value of the expected future cash flows of the business, excluding financing and tax, (the 'value-in-use') to the carrying value of the underlying net assets. If the net assets 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 2001 would be £94 million lower (2000: £78 million lower), with a corresponding reduction in reserves of £172 million (2000: £78 million); intangible assets on the balance sheet would also be £172 million lower (2000: £78 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.

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.

1 Accounting policies (continued)

e Provisions for bad and doubtful debts and non-performing lending (continued)

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 holds general provisions 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 and 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 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 where 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 significant 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 estimated realisable value and interest is no longer charged to the customer's account as its recovery is considered unlikely. 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.

g Debt securities and equity shares

Debt securities, apart from those held for dealing purposes, 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. Debt securities acquired in exchange for advances to countries experiencing payment difficulties are included in the Group's portfolio of investment securities at an amount based on the market value at the date of exchange as adjusted for the amortisation of discount on acquisition. Equity shares, apart from those held for dealing purposes, 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.

h Shares in group undertakings

Shares in group undertakings are stated in the balance sheet of the Company at its share of net tangible assets, with the exception of the life assurance group undertakings which are stated on the basis described in o. Attributable goodwill is included, where this has not been written off directly to reserves.

i 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 investment, taking into account anticipated residual values. Anticipated residual values are reviewed regularly and any impairments identified are charged to the profit and loss account.

j 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.

k 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 both finance and operating 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.

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.

l Deferred tax

Deferred tax is provided at the appropriate rates of tax where there is a reasonable probability that a liability or asset will crystallise in the foreseeable future.

m Pensions and other post-retirement benefits

The cost of providing pension benefits is charged to the profit and loss account so as to spread the expected cost of pensions, calculated in accordance with actuarial advice, on a systematic basis over employees' working lives. The pension cost is assessed in accordance with the advice of qualified actuaries, using the projected unit method. Variations from the regular cost are allocated by equal annual instalments over the average remaining service lives of current employees.

The cost of providing post-retirement benefits other than pensions is charged to the profit and loss account on a systematic basis over employees'

m Pensions and other post-retirement benefits (continued)

working lives. The unfunded liability is included as a provision in the balance sheet.

n 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 other exchange profits or losses, which arise from normal trading activities, are included in the profit and loss account.

o Long-term assurance business

A number of the Group's subsidiary undertakings are engaged in writing long-term assurance business, including the provision of life assurance, pensions, annuities and permanent health insurance contracts. In common with other life assurance companies in the UK, these companies are structured into one or more long-term business funds, depending upon the nature of the products being written, and a shareholder's fund. All premiums received, investment returns, claims and expenses, and changes in liabilities to policyholders are accounted for within the related long-term business fund. Any surplus, which is determined annually by the Appointed Actuary after taking account of these items, may either be distributed between the shareholder and the policyholders according to a predetermined formula or retained within the long-term business fund. The shareholder will also levy investment management and administration charges upon the long-term business fund.

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 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.

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 are legally owned by the life assurance companies, however the shareholder will only benefit from ownership of these assets to the extent that surpluses are declared or from other cashflows 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.

p 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.

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 options together with interest rate swaps, forward rate agreements and options. These derivatives are accounted for on an accruals basis, in line with the treatment of 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 adequate evidence of the intention to hedge at the outset of the transaction and the derivative substantially matches or eliminates 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

	Profit on ordinary activities before tax 2001 £m	2000* £m
Class of business:		
UK Retail Banking and Mortgages		
Profit before exceptional restructuring costs	**1,588**	1,665
Exceptional restructuring costs	**(150)**	(99)
	1,438	1,566
Insurance and Investments		
Operating profit	**1,601**	1,425
Short-term fluctuations in investment returns	**(648)**	(94)
Changes in economic assumptions	**–**	127
Exceptional restructuring costs	**(50)**	(59)
Pension provisions	**(70)**	(100)
Stakeholder pension related charge	**–**	(80)
	833	1,219
UK Retail Financial Services	**2,271**	2,785
Wholesale Markets and International Banking		
Profit before exceptional restructuring costs	**1,381**	1,223
Exceptional restructuring costs	**(17)**	(30)
	1,364	1,193
Central group items	**(124)**	(118)
Profit on sale of businesses	**39**	–
	3,550	3,860

Operating profit from Insurance and Investments is further analysed as follows:

	2001 £m	2000 £m
Life and pensions	**868**	750
Unit trusts	**46**	48
General insurance	**668**	587
Asset management	**19**	40
	1,601	1,425

The operating profit for the life and pensions business shown above reconciles to the income from long-term assurance business shown in the profit and loss account as follows:

	2001 £m	2000 £m
Life and pensions segmental profit	**868**	750
Items separately disclosed:		
Short-term fluctuations in investment returns	**(602)**	(67)
Changes in economic assumptions	**–**	127
Stakeholder pension related charge	**–**	(80)
Pension provisions	**(70)**	(100)
	(672)	(120)
Other items	**(3)**	(15)
Income from long-term assurance business	**193**	615

Geographical area:**	Domestic 2001 £m	International 2001 £m	Total 2001 £m
Interest receivable	**8,950**	**2,414**	**11,364**
Fees and commissions receivable	**2,636**	**286**	**2,922**
Dealing profits (before expenses)	**138**	**95**	**233**
Income from long-term assurance business	**181**	**12**	**193**
General insurance premium income	**428**	**–**	**428**
Other operating income	**538**	**170**	**708**
Total gross income	**12,871**	**2,977**	**15,848**
Profit on ordinary activities before tax	**2,984**	**566**	**3,550**

	Domestic 2000 £m	International 2000* £m	Total 2000* £m
Interest receivable	8,927	2,127	11,054
Fees and commissions receivable	2,480	288	2,768
Dealing profits (before expenses)	149	49	198
Income from long-term assurance business	607	8	615
General insurance premium income	399	–	399
Other operating income	269	167	436
Total gross income	12,831	2,639	15,470
Profit on ordinary activities before tax	3,427	433	3,860

	Net assets† 2001 £m	Net assets† 2000* £m	Assets‡ 2001 £m	Assets‡ 2000* £m
Class of business:				
UK Retail Banking and Mortgages	**2,437**	2,235	**77,915**	71,292
Insurance and Investments	**7,019**	6,508	**9,478**	9,437
UK Retail Financial Services	**9,456**	8,743	**87,393**	80,729
Wholesale Markets and International Banking	**3,965**	3,377	**101,471**	86,030
Central group items	**(2,624)**	(2,059)	**1,286**	1,269
	10,797	10,061	**190,150**	168,028
Geographical area:**				
Domestic	**9,723**	9,129	**161,542**	144,898
International	**1,074**	932	**28,608**	23,130
	10,797	10,061	**190,150**	168,028

*2000 figures have been restated to take account of the implementation of Financial Reporting Standard 18 "Accounting Policies" (note 1) and changes in internal transfer pricing.

**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 (SSAP25); 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.

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)

	2001 £m	2000 £m
Foreign exchange trading income	**158**	141
Securities and other gains	**75**	57
	233	198

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

	2001 £m	2000 £m
Salaries and profit sharing	**1,953**	1,862
Social security costs	**140**	131
Other pension costs (note 45)	**(108)**	(105)
Staff costs	**1,985**	1,888
Other administrative expenses	**1,572**	1,490
	3,557	3,378

The average number of persons on a headcount basis employed by the Group during the year was as follows:

	2001	2000
UK	**71,184**	67,848
Overseas	**11,768**	11,847
	82,952	79,695

The above staff numbers exclude 5,450 (2000: 6,152) staff employed in the long-term assurance business. Costs of £168 million (2000: £199 million) in relation to those staff are reflected in the valuation of the long-term assurance fund.

Details of directors' emoluments, pensions and interests are given on pages 48 to 51.

During the year PricewaterhouseCoopers earned the following fees:

	2001 £m	2000 £m
Statutory audit	**4**	4
Due diligence and other audit-related work	**13**	7
Audit and similar services	**17**	11
Consultancy and advisory services	**4**	25
Total fees	**21**	36

The auditors' remuneration for the holding company was £50,000 (2000: £50,000).

The increase in due diligence and other audit-related work in 2001 comprises principally work in relation to the Group's listing on the New York Stock Exchange and in connection with the bid for Abbey National.

It is the Group's policy to employ PricewaterhouseCoopers on assignments additional to their statutory audit duties, where their expertise and experience with the Group are important, principally relating to tax advice and due diligence reporting on acquisitions, or where they are selected on a competitive basis.

It is the Group's policy to seek competitive tenders for all consultancy projects.

5 Exceptional restructuring costs

In February 2000 the Group announced an efficiency initiative aimed at reducing its overall cost base, which continued during 2001. The initiative focuses on improving the Group's infrastructure, consolidation of large scale processing operations and support functions and streamlining of the branch network, combined with the expansion of lower cost delivery channels, all of which contributes towards an enhancement in organisational efficiency and customer service. Costs of £167 million (2000: £108 million) were incurred in connection with this programme, mainly comprising severance, software write-off and consultancy costs.

Following the acquisition of Scottish Widows in 2000, the Group has been progressively integrating its businesses with its existing insurance and investment activities and rationalising the processes. During 2001, costs of £50 million (2000: £59 million) were incurred, principally relating to the integration and centralisation of back office support functions, the streamlining and automation of client service processes and the redefinition of the sales process.

A provision of £21 million was made in 2000 to cover the cost of integrating Chartered Trust Group plc and ACL Autolease Holdings Limited following their acquisition in September 2000.

6 Amounts written off fixed asset investments

	2001 £m	2000* £m
Debt securities	**58**	27
Equity shares	**2**	5
	60	32

*restated (see note 1)

7 Profit before tax on sale of businesses

On 3 October 2001 the Group announced the sale of its Brazilian fund management and private banking business, including its subsidiary, Lloyds TSB Asset Management S.A. This resulted in a profit on sale of £39 million (tax: £11 million).

8 Profit on ordinary activities before tax

Profit on ordinary activities before tax is stated after taking account of:

	2001 £m	2000* £m
Income from:		
Aggregate amounts receivable in respect of assets leased to customers and banks under:		
Finance leases and hire purchase contracts	**3,250**	3,295
Operating leases	**329**	151
Profit less losses on disposal of investment securities	**160**	127
Charges:		
Rental of premises	**203**	193
Hire of equipment	**18**	26
Interest on subordinated liabilities (loan capital)	**493**	490

*restated (see note 1)

9 Tax on profit on ordinary activities

	2001 £m	2000* £m
UK corporation tax		
Current tax on profits for the year	**836**	941
Adjustments in respect of prior years	**(14)**	3
	822	944
Double taxation relief	**(87)**	(72)
	735	872
Foreign tax		
Current tax on profits for the year	**179**	137
Adjustments in respect of prior years	**(17)**	(5)
	162	132
Current tax charge	**897**	1,004
Deferred tax	**73**	100
Associated undertakings and joint ventures	**1**	1
	971	1,105

*restated (see note 1)

The charge for tax on the profit for the year is based on a UK corporation tax rate of 30 per cent (2000: 30 per cent).

The UK corporation tax charge includes £74 million (2000: £171 million) in respect of notional tax on the shareholder's interest in the increase in the value of the long-term assurance business.

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

	2001 £m	2000 £m
Tax charge at UK corporation tax rate of 30%	**1,065**	1,158
Change in non-allowable provisions	**(14)**	3
Goodwill amortisation	**8**	10
Overseas tax rate differences	**21**	14
Non-allowable items	**17**	13
Gains covered by capital losses brought forward	**(39)**	(14)
Tier 1 capital	**(19)**	(12)
Payments to employee trust	**(60)**	(37)
Other items	**(8)**	(30)
Tax on profit on ordinary activities	**971**	1,105
Effective rate	**27.4%**	28.6%

10 Profit for the financial year attributable to shareholders

The profit attributable to shareholders includes a profit of £1,893 million (2000: £1,699 million) dealt with in the accounts of the parent company, for which no profit and loss account is shown as permitted by Section 230 of the Companies Act 1985.

11 Ordinary dividends

	2001 pence per share	2000 pence per share	2001 £m	2000 £m
Interim: paid	**10.2**	9.3	**566**	511
Final: proposed	**23.5**	21.3	**1,306**	1,172
	33.7	30.6	**1,872**	1,683

12 Earnings per share

	2001	2000*
Profit attributable to shareholders†	**£2,500m**	£2,706m
Weighted average number of ordinary shares in issue during the year††	**5,533m**	5,487m
Dilutive effect of options outstanding	**50m**	58m
Diluted weighted average number of ordinary shares in issue during the year	**5,583m**	5,545m
Earnings per share	**45.2p**	49.3p
Diluted earnings per share	**44.8p**	48.8p

*restated (see note 1)

†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 15 million (2000: 9 million) ordinary shares held by Lloyds TSB Group Holdings (Jersey) Limited and the trustees of the TSB Group Employee Trust, the Lloyds TSB Group Employee Share Ownership Trust and the Lloyds TSB Qualifying Employee Share Ownership Trust, on which dividends have been waived (note 27).

13 Treasury bills and other eligible bills

	2001 Balance sheet £m	2001 Valuation £m	2000 Balance sheet £m	2000 Valuation £m
Investment securities:				
Treasury bills and similar securities	**748**	**748**	121	119
Other eligible bills	**2,034**	**2,032**	509	508
	2,782	**2,780**	630	627
Other securities:				
Treasury bills and similar securities	**1,630**		1,032	
Other eligible bills	**–**		47	
	1,630		1,079	
	4,412		1,709	
Included above:				
Unamortised discounts net of premiums on investment securities	**6**		2	

Movements in investment securities comprise:	Cost £m	Premiums and discounts £m	Total £m
At 1 January 2001	**626**	**4**	**630**
Exchange and other adjustments	**(3)**	**–**	**(3)**
Additions	**28,367**	**–**	**28,367**
Bills sold or matured	**(26,213)**	**(80)**	**(26,293)**
Amortisation of premiums and discounts	**–**	**81**	**81**
At 31 December 2001	**2,777**	**5**	**2,782**

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes.

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.

14 Loans and advances to banks

	2001 £m	2000* £m
Lending to banks	**1,616**	565
Deposits placed with banks	**13,610**	14,731
Total loans and advances to banks	**15,226**	15,296
Provisions for bad and doubtful debts	**(2)**	(6)
	15,224	15,290
Repayable on demand	**2,443**	2,794
Other loans and advances by residual maturity repayable:		
3 months or less	**8,995**	10,352
1 year or less but over 3 months	**2,698**	1,365
5 years or less but over 1 year	**708**	478
Over 5 years	**382**	307
Provisions for bad and doubtful debts	**(2)**	(6)
	15,224	15,290

*restated (see note 1)

15 Loans and advances to customers

	2001 £m	2000* £m
Lending to customers	**111,541**	102,648
Hire purchase debtors	**5,345**	5,172
Equipment leased to customers	**7,585**	8,122
Total loans and advances to customers	**124,471**	115,942
Provisions for bad and doubtful debts	**(1,466)**	(1,420)
Interest held in suspense	**(70)**	(90)
	122,935	114,432
Loans and advances by residual maturity repayable:		
3 months or less	**20,468**	20,968
1 year or less but over 3 months	**9,792**	8,216
5 years or less but over 1 year	**27,910**	24,313
Over 5 years	**66,301**	62,445
Provisions for bad and doubtful debts	**(1,466)**	(1,420)
Interest held in suspense	**(70)**	(90)
	122,935	114,432
Of which repayable on demand or at short notice	**7,804**	9,342

*restated (see note 1)

The cost of assets acquired during the year for letting to customers under finance leases and hire purchase contracts amounted to £3,166 million (2000: £2,754 million).

Securitisations
Certain instalment credit receivables have been securitised and are subject to non-returnable financing arrangements. In accordance with Financial Reporting Standard 5, these items have been shown under the linked presentation method.

The Group's subsidiary, Black Horse Limited (formerly Chartered Trust plc), entered into transactions whereby it disposed of its interest in portfolios of motor vehicle and caravan instalment credit agreements for a total of £980 million to Cardiff Automobile Receivables Securitisation (UK) No 4 plc (CARS 4). CARS Trustee (UK) No 4 Limited is responsible for the collection and onward payment of all amounts falling due under the terms of the receivables sold to CARS 4. Principal receipts up to 10 December 2000 were used to purchase further receivables; subsequent to this date they are being used to redeem floating rate notes. Income receipts are applied in the following order of priority: interest due on the floating rate notes; credit manager fees; payments under swaps; amounts due to third parties; dividends; and residual income to Black Horse Limited. Black Horse Limited has been appointed by CARS Trustee (UK) No 4 Limited as credit manager and receives a fee for fulfilling this function. It has no liability to the noteholders or any creditor of CARS 4 or CARS Trustee (UK) No 4 Limited other than through failure to meet its obligations as credit manager or for breach of warranties given. Black Horse Limited has no interest in the share capital of CARS 4 or CARS Trustee (UK) No 4 Limited.

Black Horse Limited and CARS 4 have also entered into interest rate swaps in respect of this transaction, the interest rates payable and receivable under these swaps are set by reference to market rates of interest on an arm's length basis.

At 31 December 2001 CARS 4 held £124 million (2000: £400 million) of receivables, matched by non-returnable finance of the same amount.

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

	2001 Specific £m	2001 General £m	2000* Specific £m	2000 General £m
At 1 January – as previously reported	**1,069**	**357**	1,762	361
Prior year adjustment (note 1)	**–**	**–**	(709)	–
At 1 January – restated	**1,069**	**357**	1,053	361
Exchange and other adjustments	**(15)**	**1**	4	(2)
Adjustments on acquisition	**–**	**–**	45	4
Advances written off	**(885)**	**–**	(745)	–
Recoveries of advances written off in previous years	**194**	**–**	165	–
Charge (release) to profit and loss account:				
New and additional provisions				
– normal coverage	**1,310**	**9**	1,093	7
– credit difficulties in Argentina	**–**	**55**	–	–
Releases and recoveries	**(574)**	**(53)**	(546)	(13)
	736	**11**	547	(6)
At 31 December	**1,099**	**369**	1,069	357
	1,468		1,426	
In respect of:				
Loans and advances to banks	**2**		6	
Loans and advances to customers	**1,466**		1,420	
	1,468		1,426	

16 Provisions for bad and doubtful debts and non-performing lending (continued)

	2001 £m	2000* £m
Non-performing lending comprises:		
Accruing loans on which interest is being placed in suspense	**843**	855
Loans accounted for on a non-accrual basis	**379**	404
	1,222	1,259
Provisions	**(829)**	(807)
Interest held in suspense	**(70)**	(90)
	323	362

*restated (see note 1)

17 Concentrations of exposure

	2001 £m	2000* £m
Loans and advances to customers		
Domestic:		
Agriculture, forestry and fishing	**2,074**	2,026
Manufacturing	**3,321**	3,357
Construction	**1,309**	1,016
Transport, distribution and hotels	**4,440**	3,836
Property companies	**2,907**	2,470
Financial, business and other services	**8,736**	9,295
Personal: mortgages	**56,578**	52,659
: other	**12,784**	11,138
Lease financing	**7,552**	8,070
Hire purchase	**5,345**	5,172
Other	**2,992**	2,526
Total domestic	**108,038**	101,565
International:		
Latin America	**2,347**	2,222
New Zealand	**8,435**	7,368
Rest of the world	**5,651**	4,787
Total international	**16,433**	14,377
	124,471	115,942
Provisions for bad and doubtful debts**	**(1,466)**	(1,420)
Interest held in suspense**	**(70)**	(90)
	122,935	114,432

*restated (see note 1)
**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.

18 Debt securities

	2001 Balance sheet £m	2001 Valuation £m	2000* Balance sheet £m	2000* Valuation £m
Investment securities:				
Government securities	**1,646**	**1,842**	1,729	2,148
Other public sector securities	**–**	**–**	1	1
Bank and building society certificates of deposit	**4,670**	**4,677**	3,034	3,034
Other debt securities	**4,673**	**4,684**	1,631	1,631
	10,989	**11,203**	6,395	6,814
Other securities:				
Government securities	**4,103**	**4,103**	3,060	3,060
Other public sector securities	**151**	**151**	131	131
Bank and building society certificates of deposit	**234**	**234**	105	105
Other debt securities	**8,748**	**8,748**	4,914	4,914
	24,225	**24,439**	14,605	15,024
Due within 1 year	**6,745**		5,405	
Due 1 year and over	**17,480**		9,200	
	24,225		14,605	
Unamortised discounts net of premiums on investment securities	**622**		904	
Investment securities:				
Listed	**4,703**	**4,900**	2,644	3,063
Unlisted	**6,286**	**6,303**	3,751	3,751
	10,989	**11,203**	6,395	6,814
Other securities:				
Listed	**11,543**	**11,543**	7,289	7,289
Unlisted	**1,693**	**1,693**	921	921
	13,236	**13,236**	8,210	8,210

*restated (see note 1)

Movements in investment securities comprise:	Cost £m	Premiums and discounts £m	Provisions £m	Total £m
At 1 January 2001 – as previously reported	**5,477**	**224**	**29**	**5,672**
Prior year adjustment (note 1)	**404**	**319**	**–**	**723**
At 1 January 2001 – restated	**5,881**	**543**	**29**	**6,395**
Exchange and other adjustments	**33**	**8**	**–**	**41**
Additions	**18,672**	**–**	**–**	**18,672**
Transfers	**(46)**	**(10)**	**–**	**(56)**
Securities sold or matured	**(13,987)**	**(84)**	**(4)**	**(14,067)**
Charge for the year	**–**	**–**	**58**	**(58)**
Amortisation of premiums and discounts	**–**	**62**	**–**	**62**
At 31 December 2001	**10,553**	**519**	**83**	**10,989**

18 Debt securities (continued)

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes.

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 Equity shares

	2001 Balance sheet £m	2001 Valuation £m	2000 Balance sheet £m	2000 Valuation £m
Investment securities:				
Listed	4	14	7	45
Unlisted	34	52	34	57
	38	66	41	102
Other securities:				
Listed	187		204	
Unlisted	–		2	
	187		206	
	225		247	

Movements in investment securities comprise:	Cost £m	Provisions £m	Total £m
At 1 January 2001	54	13	41
Exchange and other adjustments	(1)	–	(1)
Additions	10	–	10
Disposals	(13)	(3)	(10)
Charge for the year	–	2	(2)
At 31 December 2001	50	12	38

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes.

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.

20 Assets transferred under sale and repurchase transactions

Included in the Group's balance sheet are assets subject to sale and repurchase agreements as follows:

	2001 £m	2000 £m
Treasury bills and other eligible bills	1,036	546
Debt securities	4,498	3,543
	5,534	4,089

These investments have been sold to third parties but, since the Group is committed to reacquire them at a future date and at a predetermined price, they are shown in the balance sheet.

21 Interests in associated undertakings and joint ventures

	£m
At 1 January 2001	9
Additions	44
Disposals	(1)
Retained profits	(13)
At 31 December 2001	39

The Group's principal investments are in two joint ventures:

	Group interest	Nature of business
iPSL	19.5% of issued ordinary share capital	Cheque processing
Goldfish Holdings Limited	25.0% of issued ordinary share capital	Financial services

During 2001 the Group established Goldfish Holdings Limited, a joint venture with Centrica plc for the provision of a broad range of financial services products through Goldfish Holdings Limited's wholly owned subsidiary, Goldfish Bank Limited. By 31 December 2001, the Group had contributed £44 million of capital to the venture.

In the year ended 31 December 2001 £27 million (2000: £4 million) of fees payable to iPSL have been included in the Group's administrative expenses and £6 million (2000: £1 million) of charges to iPSL have been included in the Group's income. The Group has also prepaid £8 million (2000: £7 million) of fees in respect of 2002 and this amount is included in prepayments and accrued income; in addition at 31 December 2001 iPSL owed £1 million (2000: £2 million) to the Group, which is included in other assets.

In the year ended 31 December 2001 £1 million of interest receivable from Goldfish Bank Limited and £22 million of charges to Goldfish Bank Limited in respect of administrative costs have been included in the Group's income. At 31 December 2001 Goldfish Bank Limited owed £611 million to the Group, which is included in loans and advances to banks.

22 Interests in group undertakings

	Company Shares £m	Company Loans £m
At 1 January 2001	11,152	759
Amounts advanced	–	100
Repayment of loans	–	(100)
Revaluation	808	–
At 31 December 2001	11,960	759

The Company's shareholding in group undertakings represents an investment in an unlisted bank.

On an historical cost basis, shares in group undertakings would have been included at cost of £6,066 million (2000: £6,066 million).

22 Interests in group undertakings (continued)

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 Bank (BLSA) Limited	England	†100%	Banking and financial services
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
The National Bank of New Zealand Limited	New Zealand	†100%	Banking and financial services
Lloyds TSB Bank (Jersey) 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 Life Assurance Company Limited	England	†100%	Life assurance and other financial services
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 Argentina, Belgium, Brazil, Dubai, Gibraltar, Guatemala, Hong Kong, Honduras, Japan, Luxembourg, Malaysia, Monaco, Netherlands, Panama, Paraguay, Singapore, Spain, Switzerland, Uruguay, the USA and a representative office in Iran. Lloyds Bank (BLSA) Limited operates in Ecuador. The National Bank of New Zealand Limited also operates through a representative office in Hong Kong.

23 Intangible fixed assets

	Cost £m	Amortisation £m	Net book value £m
Goodwill			
At 1 January 2001	**2,635**	**36**	**2,599**
Exchange and other adjustments	**(3)**	**(1)**	**(2)**
Acquisitions (note 48)	**8**	**–**	**8**
Charge for the year	**–**	**39**	**(39)**
At 31 December 2001	**2,640**	**74**	**2,566**

24 Tangible fixed assets

	Premises £m	Equipment £m	Operating lease assets £m
Cost:			
At 1 January 2001	**1,052**	**2,343**	**1,411**
Exchange and other adjustments	**(14)**	**(22)**	**8**
Additions	**91**	**310**	**680**
Disposals	**(55)**	**(361)**	**(328)**
At 31 December 2001	**1,074**	**2,270**	**1,771**
Depreciation:			
At 1 January 2001	**284**	**1,354**	**131**
Exchange and other adjustments	**(4)**	**(10)**	**–**
Charge for the year	**61**	**253**	**197**
Disposals	**(7)**	**(319)**	**(190)**
At 31 December 2001	**334**	**1,278**	**138**
Balance sheet amount at 31 December 2001	**740**	**992**	**1,633**
		3,365	
Balance sheet amount at 31 December 2000	768	989	1,280
		3,037	

	2001 £m	2000 £m
Balance sheet amount of premises comprises:		
Freeholds	**436**	490
Leaseholds 50 years and over unexpired	**36**	22
Leaseholds less than 50 years unexpired	**268**	256
	740	768
Land and buildings occupied for own activities	**664**	691

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:

	2001 £m	2000 £m
Residual value expected to be recovered in:		
1 year or less	**156**	134
2 years or less but over 1 year	**119**	108
5 years or less but over 2 years	**388**	367
Over 5 years	**482**	301
Total exposure	**1,145**	910

25 Lease commitments

Annual commitments under non-cancellable operating leases were:

	2001 Premises £m	2001 Equipment £m	2000 Premises £m	2000 Equipment £m
Leases on which the commitment is due to expire in:				
1 year or less	**7**	**5**	3	1
5 years or less but over 1 year	**33**	**3**	18	2
Over 5 years	**181**	**–**	184	–
	221	**8**	205	3

Obligations under finance leases were:

	2001 Equipment £m	2000 Equipment £m
Amounts payable in:		
1 year or less	**3**	20
5 years or less but over 1 year	**–**	3
	3	23

26 Capital commitments

Capital expenditure contracted but not provided for at 31 December 2001 amounted to £137 million (2000: £33 million), of which £125 million (2000: £28 million) relates to assets to be leased to customers under operating leases.

27 Own shares

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 the Lloyds TSB Group. The Company has lent £22 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. The cost of providing these shares is charged to the profit and loss account on a systematic basis over the period that the employees are expected to benefit. At 31 December 2001, 2 million shares were held by the trustees with a book value of £15 million and a market value of £15 million. (2000: 3 million shares with a book value of £24 million and a market value of £22 million).

Lloyds TSB Group plc also sponsored the TSB Group Employee Trust, a further discretionary trust for the benefit of employees and former employees of the Lloyds TSB Group. The shares in this trust were exhausted during 2001; at 31 December 2000, 0.1 million shares were held by the trustees with a book value of £0.2 million and a market value of £0.5 million. The trust currently holds no assets and full provision has been made against the outstanding amount of the Company's loan to the trust.

The Group has also established the Lloyds TSB Qualifying Employee Share Ownership Trust ('the QUEST') for the purpose of delivering shares on the exercise of options under certain of the Group's Save As You Earn (SAYE) share option schemes. During 2001, Lloyds TSB Group plc contributed £200 million to the QUEST, and the trustees subscribed for 47 million shares in the Company for a consideration of £316 million. During 2000, Lloyds TSB Group plc contributed £122 million and the trustees subscribed for 30 million shares for a consideration of £193 million. At 31 December 2001, 2 million shares were held by the QUEST with a book value of £8 million (2000: 1 million shares with a book value of £4 million) reflecting the exercise price of the options the shares are expected to be used to satisfy. Under the terms of the QUEST's trust deed, the trustees have waived all but a nominal dividend on the shares they hold. The difference between the amount contributed by the Company and the book value of the shares held by the QUEST at 31 December 2001 has been charged to profit and loss account reserves.

In addition, a further 0.5 million ordinary shares were held by Lloyds TSB Group Holdings (Jersey) Limited at 31 December 2001 (2000: 0.8 million shares). These shares, on which the dividend entitlement has been waived, were gifted to the Group some years ago at nil cost and are used to satisfy outstanding options or to meet commitments arising under other employee share schemes.

28 Other assets

	2001 £m	2000* £m
Foreign exchange and interest rate contracts (note 47a)	**2,090**	2,688
Balances arising from derivatives used for hedging purposes	**931**	431
Settlement balances	**570**	121
Other assets	**877**	758
	4,468	3,998

*restated (see note 1)

29 Prepayments and accrued income

	2001 £m	2000 £m
Interest receivable	**843**	875
Pensions prepayment	**894**	768
Deferred expenditure incurred under cash gift and discount mortgage schemes	**256**	242
Other debtors and prepayments	**1,197**	1,080
	3,190	2,965

30 Long-term assurance business

a Methodology

The value of the shareholder's interest in the long-term assurance business ('the embedded value') is comprised of the net tangible assets of the life assurance subsidiaries, including any surplus retained in the long-term business funds, which could be transferred to shareholders, and the present value of the in-force business. The value of the in-force business is calculated by projecting future surpluses and other net cash flows attributable to the shareholder arising from business written by the balance sheet date and discounting the result at a rate which reflects the shareholder's overall risk premium.

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 and described as income from long-term assurance business. For the purpose of presentation the change in this value is grossed up at the underlying rate of corporation tax.

30 Long-term assurance business (continued)

b Analysis of embedded value

The embedded value included in the consolidated balance sheet comprises:

	2001 £m	2000 £m
Net tangible assets of life companies including surplus	**3,985**	4,128
Value of other shareholder's interests in the long-term assurance business	**2,589**	2,421
	6,574	6,549

Movements in the embedded value balance have been as follows:

	2001 £m	2000 £m
At 1 January	**6,549**	2,274
Exchange and other adjustments	**(35)**	(92)
Profit after tax	**115**	441
Capital injection	**100**	–
Dividends	**(155)**	(126)
Acquisitions	**–**	4,052
	6,574	6,549

c 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.

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; and
- The effects of changes in assumptions other than economic assumptions and other items.

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.

Distribution costs: this represents the actual cost of acquiring new business during the year and includes commissions paid to independent financial advisors and other direct sales costs.

Included within other items are:

Short-term fluctuations in investment returns: 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: this is recognised immediately; and (b) the effect of these fluctuations on the value of in-force business which is recognised using smoothed fund values.

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

Exceptional items: this includes any other items which, by virtue of their size or incidence, are considered not to form part of the ongoing operating profit.

Income from long-term assurance business is set out below:

	2001 £m	2000 £m
New business contribution	**374**	305
Contribution from existing business		
– expected return	**359**	311
– experience variances	**37**	36
– changes in assumptions and other items	**95**	96
Investment earnings	**247**	212
Distribution costs	**(247)**	(225)
Operating profit	**865**	735
Short-term fluctuations in investment returns	**(602)**	(67)
Changes in economic assumptions	**–**	127
Exceptional items		
– Pension provisions (see d)	**(70)**	(100)
– Stakeholder pension related charge (see e)	**–**	(80)
Income from long-term assurance business before tax	**193**	615
Attributed tax	**(78)**	(174)
Income from long-term assurance business after tax	**115**	441

Income before tax from long-term assurance business can also be analysed as follows:

	2001 £m	2000 £m
Income net of claims and technical provisions	**636**	937
Pension provisions	**(70)**	(100)
Operating expenses	**(557)**	(471)
Tax charged to technical account	**(62)**	(191)
(Deficit retained) surplus emerging	**(53)**	175
Value of in-force business	**168**	266
Income from long-term assurance business after tax	**115**	441
Tax	**78**	174
Income from long-term assurance business before tax	**193**	615

d Pension provisions

During the early 1990s, there was increasing concern in the UK that many customers had been given poor advice when they were advised to set up their own personal pension plan and that they would, in fact, have been in a better position if they had remained in, or joined, employer sponsored pension schemes. The regulator of the UK pension industry (now the responsibility of the Financial Services Authority) carried out an industry wide investigation into the conduct of business involving the transfer of pensions. The conclusion of the investigation was that a large number of customers had been poorly advised, by insurance companies and intermediaries across the industry. As a result of this investigation the regulator established an action plan for the UK pensions industry to follow in reviewing all cases of possible misselling and determining the necessary compensation. As the review of pension cases in the Group has progressed, provisions have been established for the estimated cost of compensation.

30 Long-term assurance business (continued)

d Pension provisions (continued)

Movements in the provision over the last two years have been as follows:

	2001 £m	2000 £m
At 1 January	**352**	397
Accrual of interest on the provision	**20**	26
Charge for the year	**70**	100
Compensation paid	**(238)**	(173)
Guarantees*	**(1)**	2
At 31 December	**203**	352

*In some cases, rather than pay cash compensation directly into the customer's personal pension plan, the Group has guaranteed to 'top up' the customer's pension income on retirement, to the level that they would have received under the relevant occupational scheme.

By the end of 2000, the Group had gained further experience as to the number and size of claims likely to require compensation, in particular those affected by the revised guidelines issued towards the end of 1999 dealing with the way in which compensation should be calculated for those customers who had opted out of the State Earnings Related Pension Scheme. After taking this into account, the cost of redress was forecast to increase by £100 million and a provision of this amount was made.

A further review of the adequacy of the provision has been carried out as at 31 December 2001. Lower stock market levels have had a significant impact on total redress costs as the cost of restitution into company pension schemes rises as personal pension fund values reduce. As a result of this and the fact that there is now greater certainty as to the number and size of compensation claims to be paid, an additional provision of £70 million has been made.

e Stakeholder pension related charge

During 1999, the government announced changes intended to encourage more of the population to provide retirement income for themselves through increased rates of savings. One of these initiatives was the introduction of stakeholder pensions with effect from April 2001; a key feature of these products is that charges are limited to 1 per cent per annum, which is significantly lower than historic charging rates on other personal pension products. In anticipation of the introduction of stakeholder pension products in 2001, during 2000 the Group decided to reduce the charges made on certain existing policies, resulting in a cost of £80 million.

f Assumptions

The economic assumptions are based upon a long-term view of economic activity and are therefore not adjusted for market movements which are considered to be short-term. This approach is considered to be the most appropriate given the long-term nature of the portfolio of products. The principal economic assumptions, which have been used consistently throughout 2001 and 2000, are as follows:

	%
Risk-adjusted discount rate (net of tax)	8.50
Return on equities (gross of tax)	8.00
Return on fixed interest securities (gross of tax)	5.25
Expenses inflation	3.00

Following the acquisition of Scottish Widows in 2000, a detailed review of the economic assumptions was carried out to ensure that they remained appropriate. As a result certain changes were made which had effect from 1 January 2000 for the Group's existing long-term assurance businesses and resulted in a credit to the profit and loss account of £127 million. The same assumptions were used to account for the Scottish Widows business from the date of acquisition.

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 reflect the recent actual experience 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% (2000: 30%). The investment earnings have been grossed up at a composite longer term tax rate of 17% (2000: 17%).
- 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 bonus.

g Balance sheet

The long-term assurance assets attributable to policyholders comprise:

	2001 £m	2000 £m
Investments	**47,910**	52,683
Premises and equipment	**16**	20
Other assets	**2,448**	2,510
	50,374	55,213
Net tangible assets of life companies including surplus	**(3,985)**	(4,128)
	46,389	51,085
Investments shown above comprise:		
Fixed interest securities	**12,642**	14,512
Stocks, shares and unit trusts	**27,018**	31,885
Investment properties	**3,722**	3,098
Other properties	**121**	10
Mortgages and loans	**102**	117
Deposits	**4,305**	3,061
	47,910	52,683
The liabilities to policyholders comprise:		
Technical provisions:		
Long-term business provision (net of reinsurance)	**24,151**	23,514
Claims outstanding (net of reinsurance)	**211**	172
Technical provisions for linked liabilities	**21,083**	24,413
Fund for future appropriations	**95**	1,667
Other liabilities	**849**	1,319
	46,389	51,085

31 Assets and liabilities denominated in foreign currencies

	2001 £m	2000* £m
Assets: denominated in sterling	133,558	126,753
: denominated in other currencies	56,592	41,275
	190,150	168,028
Liabilities: denominated in sterling	133,661	127,267
: denominated in other currencies	56,489	40,761
	190,150	168,028

*restated (see note 1)

32 Deposits by banks

	2001 £m	2000 £m
Repayable on demand	6,634	4,330
Other deposits by banks with agreed maturity dates or periods of notice by residual maturity repayable:		
3 months or less	14,227	9,712
1 year or less but over 3 months	2,529	1,790
5 years or less but over 1 year	751	695
Over 5 years	169	208
	24,310	16,735

33 Customer accounts

	2001 £m	2000* £m
Repayable on demand	80,635	74,404
Other customer accounts with agreed maturity dates or periods of notice by residual maturity repayable:		
3 months or less	19,902	21,064
1 year or less but over 3 months	2,889	3,522
5 years or less but over 1 year	3,369	2,582
Over 5 years	2,321	417
	109,116	101,989

*restated (see note 1)

34 Debt securities in issue

	2001 £m	2000 £m
Bonds and medium-term notes by residual maturity repayable:		
1 year or less	589	538
2 years or less but over 1 year	178	169
5 years or less but over 2 years	405	472
Over 5 years	928	1,413
	2,100	2,592
Other debt securities by residual maturity repayable:		
3 months or less	17,070	8,574
1 year or less but over 3 months	4,931	6,476
5 years or less but over 1 year	104	241
Over 5 years	215	16
	22,320	15,307
	24,420	17,899

35 Short-term borrowings

The short-term borrowings of the Company in 2000 comprised floating rate unsecured loan notes which were repaid during 2001. These notes were not subordinated and bore interest at rates set periodically in advance based on London Interbank rates.

36 Other liabilities

	2001 £m	2000* £m
Foreign exchange and interest rate contracts (note 47a)	2,288	2,346
Balances arising from derivatives used for hedging purposes	475	1,071
Current tax	598	631
Dividends	1,306	1,172
Settlement balances	542	232
Other liabilities	1,464	1,148
	6,673	6,600

*restated (see note 1)

37 Accruals and deferred income

	2001 £m	2000* £m
Interest payable	1,310	1,670
Other creditors and accruals	2,253	2,504
	3,563	4,174

*restated (see note 1)

38 Deferred tax

	2001 £m	2000* £m
Short-term timing differences	(89)	(59)
Pensions prepayment	268	230
Emerging Markets Debt securities	(70)	(74)
Accelerated depreciation allowances	1,610	1,586
	1,719	1,683

	£m
At 1 January 2001 – as previously reported	1,559
Prior year adjustment (note 1)	124
At 1 January 2001 – restated	1,683
Exchange and other adjustments	7
Adjustments on disposal	(44)
Tax provided	73
At 31 December 2001	1,719

*restated (see note 1)

	2001 £m	2000 £m
Potential tax for which no provision has been made relating to accelerated depreciation allowances on equipment leased to customers	72	72

Provision has been made for the liability to tax on overseas earnings which are expected to be remitted to the UK. No provision has been made for the liability to tax which could arise if premises, to the extent that the tax base cost has been reduced by rollover relief, or group undertakings were disposed of at their balance sheet amounts. It is expected that the majority of these assets will be retained in the business and that, in view of the substantial number of assets involved and the law relating to rollover relief, the likelihood of any such material tax liability arising is remote; no useful purpose would be served by attempting to quantify it. If deferred tax were to be provided in respect of general bad debt provisions the deferred tax asset would be £90 million.

39 Other provisions for liabilities and charges

	Pension obligations £m	Insurance provisions £m	Post-retirement healthcare £m	Vacant leasehold property £m	Other £m	Total £m
At 1 January 2001	**34**	**202**	**76**	**96**	**34**	**442**
Exchange and other adjustments	**–**	**6**	**–**	**–**	**(1)**	**5**
Provisions applied	**(1)**	**(178)**	**(4)**	**(17)**	**(17)**	**(217)**
Charge for the year	**1**	**174**	**3**	**(10)**	**3**	**171**
At 31 December 2001	**34**	**204**	**75**	**69**	**19**	**401**

Pension obligations
A description of the Group's pension arrangements is provided in note 45a).

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, claims equalisation provisions are maintained in relation to property, credit and suretyship 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.

Post-retirement healthcare
A description of the Group's post-retirement healthcare obligations is provided in note 45b).

Vacant leasehold property
Whenever the Group ceases to occupy a property, or commits itself to doing so, it is the Group's policy to raise a provision to cover any anticipated shortfall when comparing the recoverable amount of its interest in the property to the future rental and other payments that the Group is obligated to make over the remaining term of the lease. These 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 normally run off over the remaining life of the leases concerned, currently averaging six years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

40 Subordinated liabilities

	Group 2001 £m	Group 2000 £m	Company 2001 £m	Company 2000 £m
* *Undated loan capital:*				
† Primary Capital Undated Floating Rate Notes:				
Series 1 (US$750 million)	**516**	502		
Series 2 (US$500 million)	**344**	335		
Series 3 (US$600 million)	**412**	401		
11¾% Perpetual Subordinated Bonds	**100**	100		
■ 5⅝% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	**757**	774		
† Undated Step-up Floating Rate Notes callable 2009 (€150 million)	**91**	94		
¶ 6⅜% Undated Subordinated Step-up Notes callable 2010	**406**	405		
✣ 5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20 billion)	**105**	117		
¶ 6½% Undated Subordinated Step-up Notes callable 2019	**266**	266		
¶ 8% Undated Subordinated Step-up Notes callable 2023	**199**	199		
⌘¶ 6½% Undated Subordinated Step-up Notes callable 2029	**455**	198		
	3,651	3,391		
Dated loan capital:				
‡ Eurocurrency Zero Coupon Bonds 2003 (¥3 billion)	**15**	15	**15**	15
§ Subordinated Fixed Rate Bonds 2003 (NZ$151 million)	**43**	49	**–**	–
† Subordinated Floating Rate Notes 2004	**15**	20	**–**	–
7⅜% Subordinated Bonds 2004	**399**	399	**–**	–
†❖ Subordinated Floating Rate Notes 2004	**100**	100	**–**	–
§ Subordinated Fixed Rate Bonds 2006	**–**	22	**–**	–
† Subordinated Floating Rate Notes 2006	**–**	100	**–**	100
8½% Subordinated Bonds 2006	**249**	249	**249**	249
7¾% Subordinated Bonds 2007	**299**	298	**–**	–
§ Subordinated Fixed Rate Bonds 2007 (NZ$150 million)	**43**	44	**–**	–
5¼% Subordinated Notes 2008 (DM750 million)	**234**	240	**–**	–
‡ 10⅝% Guaranteed Subordinated Loan Stock 2008	**100**	100	**–**	–
9½% Subordinated Bonds 2009	**99**	99	**–**	–
† Subordinated Step-up Floating Rate Notes 2009 callable 2004 (US$500 million)	**343**	334	**–**	–
Subordinated Fixed Rate Bonds 2010 (NZ$100 million)	**29**	30	**–**	–
6¼% Subordinated Notes 2010 (€400 million)	**244**	250	**–**	–
† Subordinated Floating Rate Notes 2010 (US$400 million)	**274**	267	**–**	–
‡ 12% Guaranteed Subordinated Bonds 2011	**100**	100	**–**	–
9⅛% Subordinated Bonds 2011	**149**	148	**149**	148
4¾% Subordinated Notes 2011 (€850 million)	**498**	508	**–**	–
✠§ Subordinated Fixed Rate Bonds 2011 (NZ$100 million)	**28**	–	**–**	–
6⅝% Subordinated Notes 2015	**343**	343	**–**	–
† Subordinated Floating Rate Notes 2020 (€100 million)	**61**	62	**–**	–
9⅝% Subordinated Bonds 2023	**341**	342	**–**	–
	4,006	4,119	**413**	512
Total subordinated liabilities	**7,657**	7,510	**413**	512

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.

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

‡ Issued by a group undertaking under the Company's subordinated guarantee and, in the case of the Eurocurrency Zero Coupon Bonds 2003, on-lent to the Company on a subordinated basis.

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

§ These bonds bear interest, to be reset 5 years before redemption date, at a fixed margin over New Zealand Government stocks.

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

✣ 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.

❖ Exchangeable at the election of the Group for further subordinated floating rate notes.

⌘ A further £257 million was issued during 2001 primarily to finance the general business of the Group.

✠ Issued during 2001 primarily to finance the general business of the Group.

40 Subordinated liabilities (continued)

Dated subordinated liabilities are repayable as follows:

	Group		Company	
	2001 £m	2000 £m	**2001 £m**	2000 £m
1 year or less	**5**	5	**–**	–
2 years or less but over 1 year	**63**	5	**15**	–
5 years or less but over 2 years	**753**	573	**249**	15
Over 5 years	**3,185**	3,536	**149**	497
	4,006	4,119	**413**	512

41 Non-equity minority interests

Non-equity minority interests comprise:

	2001 £m	2000 £m
Euro Step-up Non-Voting Non-Cumulative Preferred Securities (€430 million) callable 2012*	**261**	267
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015†	**248**	248
6.625% Perpetual Capital Securities (€750 million)§	**451**	–
	960	515

*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 2.33 per cent 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 3.50 per cent 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.

§These securities were issued during 2001, by Lloyds TSB Bank plc, primarily to finance the general business of the Group. Interest payments accrue at the rate of 6.625 per cent per annum; in certain circumstances these payments 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.

42 Called-up share capital

	2001 £m	2000 £m
Authorised:		
Sterling		
Ordinary shares of 25p each	**1,728**	1,728
Limited voting ordinary shares of 25p each	**20**	20
Preference shares of 25p each	**44**	44
	1,792	1,792
US dollars	**US$m**	US$m
Preference shares of US25 cents each	**40**	40
Euro	**€m**	€m
Preference shares of €25 cents each	**40**	40
Japanese yen	**¥m**	¥m
Preference shares of ¥25 each	**1,250**	1,250

	Ordinary shares of 25p each £m	Limited voting ordinary shares of 25p each £m	Total £m
Issued and fully paid:			
At 1 January 2001	**1,376**	**20**	**1,396**
Issued to the QUEST (note 27)	**12**	**–**	**12**
Issued under employee share schemes	**3**	**–**	**3**
At 31 December 2001	**1,391**	**20**	**1,411**

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.

At 31 December 2001, options to acquire 123 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 2011. These include the option, described on page 47, to acquire 216,763 shares under the share retention plan: otherwise the options are exercisable at prices ranging from 124p to 888p per share.

43 Reserves

	Group £m	Company £m
Share premium account:		
At 1 January 2001	**595**	**595**
Premium arising on issue of shares	**364**	**364**
At 31 December 2001	**959**	**959**
Revaluation reserve:		
At 1 January 2001		**5,086**
Increase in net tangible assets of subsidiary undertakings		**808**
At 31 December 2001		**5,894**
Merger reserve:		
At 1 January 2001 and 31 December 2001	**343**	**–**
Profit and loss account:		
At 1 January 2001 – as previously reported	**7,403**	**2,657**
Prior year adjustment (note 1)	**287**	**–**
At 1 January 2001 – restated	**7,690**	**2,657**
Exchange and other adjustments	**(86)**	**–**
Shares issued to the QUEST (note 27)	**(185)**	**(182)**
Retained profit	**628**	**21**
At 31 December 2001	**8,047**	**2,496**

The Group profit and loss account reserves at 31 December 2001 include £1,564 million (2000: £1,396 million) 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 cumulative amount of premiums on acquisitions written off against reserves during previous years amounts to £2,271 million of which £1,817 million was within the last 10 years.

44 Related party transactions

a Transactions, arrangements and agreements involving directors and others

At 31 December 2001, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons and with officers included:

	2001 Number of persons	2001 Total £000	2000 Number of persons	2000 Total £000
Loans and credit card transactions:				
Directors and connected persons	**7**	**1,343**	10	119
Officers	**28**	**4,113**	36	4,993

b Group undertakings

Details of the principal group undertakings are given in note 22. In accordance with FRS 8, transactions or balances with group entities that have been eliminated on consolidation are not reported.

c Associated undertakings and joint ventures

Details of the Group's associated undertakings and joint ventures are provided in note 21. Information relating to transactions entered into between Group undertakings and the joint ventures and details of outstanding balances at 31 December 2001 are also shown in note 21.

d Long-term assurance business

The Group enters into certain 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 2001 Group entities owed £1,186 million (2000: £1,251 million) and were owed £299 million (2000: £289 million); these amounts are included in customer accounts and loans and advances to customers respectively. In addition, fees of £62 million (2000: £68 million) were received, and fees of £28 million (2000: £29 million) were paid, in respect of asset management services.

Certain administrative properties used by Scottish Widows are owned by the long-term assurance funds. During 2001 Scottish Widows paid rent to the long-term assurance funds amounting to £4 million (2000: £3 million). In addition, at 31 December 2001, the long-term assurance funds owned 31 million ordinary shares in the Company (2000: 31 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 2001, the Group's pension funds had call deposits with Lloyds TSB Bank plc amounting to £572 million (2000: £344 million).

45 Pensions and other post-retirement benefits

a Pension costs in the consolidated accounts

There was a net credit in respect of pension costs for the Group in 2001 of £108 million (2000: credit of £105 million), which included a credit of £126 million (2000: credit of £121 million) relating to Lloyds TSB Group Pension Schemes No's 1 and 2.

Pension arrangements for most of the staff in the UK and the majority of those overseas are operated through defined benefit schemes funded by Group companies. The principal schemes in operation are Lloyds TSB Group Pension Schemes No's 1 and 2. The defined benefit sections of these schemes are now closed to new members. Pension arrangements for staff joining Lloyds TSB Group Pension Scheme No. 1 after 1 January 1996 and Lloyds TSB Group Pension Scheme No. 2 after 1 January 1998 are through money purchase elements of these schemes. Arrangements for pensions of certain staff employed overseas who are not included in funded schemes are made in accordance with local regulations and custom.

Full actuarial valuations of Lloyds TSB Group Pension Schemes No's 1 and 2 are carried out every three years with interim reviews in the intervening years. At 30 June 1999, the date of the latest full actuarial valuations, the principal actuarial assumptions adopted were that, over the long term, the annual real rate of return on new investments would be 3 per cent higher than the annual increase in pensionable remuneration, 4 per cent higher than the annual increase in present and future pensions in payment, and 3 per cent higher than the annual increase in dividends receivable. The market value of the assets of the schemes at this date was £11,748 million. The actuarial value of the assets represented 125 per cent of the accrued liabilities allowing for future increases in pensions and pensionable remuneration. For funding purposes, the surpluses in the two schemes are being eliminated by means of a contribution holiday.

Contribution rates to other schemes have been adjusted to take account of surpluses and deficiencies.

The following balances relating to the Group's pension schemes are included in the consolidated balance sheet:

	2001 £m	2000 £m
Pension asset related to Lloyds TSB Group Pension Schemes No's 1 and 2	**894**	768
Pension obligation relating to certain overseas schemes	**(34)**	(34)
Deferred tax	**(268)**	(230)
Net asset	**592**	504

45 Pension and other post-retirement benefits (continued)

b Post-retirement healthcare costs in the consolidated accounts

The Group operates a number of schemes which provide post-retirement health care 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 dependants) who retired prior to 1 January 1996. For retirements subsequent to this date, the Group will meet a reducing proportion of the cost until 31 December 2004, after which date the only obligation will be in respect of the pre 1 January 1996 retirements. The cost of providing all post-retirement health care benefits is charged to the profit and loss account on a systematic basis over the employees' working lives; the provision represents the unfunded obligation and is based on valuations of the Group's liability by qualified actuaries.

The total cost for the Group in 2001 was £3 million (2000: £3 million). For the principal scheme, the latest actuarial valuation of the liability was carried out at 31 December 2000. This valuation showed the Group's liability to be £72 million, which had been fully provided for at that date. The principal actuarial assumptions adopted were that, over the long term, the valuation discount rate and the rate of increase in medical costs would be 4 per cent and 3 per cent respectively higher than annual price inflation.

c Disclosures made in accordance with Financial Reporting Standard 17

As explained in note 1, the Group has adopted the requirements of Financial Reporting Standard 17 "Retirement Benefits" during the year. Under the transitional arrangements of this accounting standard the Group continues to account for pension costs in accordance with Statement of Standard Accounting Practice 24, but the following additional disclosures are required.

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 2001, the Group made no contributions to these schemes. 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 last full valuations of the schemes were carried out as at 30 June 1999; interim reviews were performed at 30 June 2001 and these have been updated to 31 December 2001 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 2001 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows.

The principal assumptions used in these updated valuations were as follows:

	%
Rate of inflation	2.50
Rate of salary increases	4.04
Rate of increase for pensions in payment and deferred pensions	2.50
Discount rate	6.00

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

	Fair value at 31 December 2001 £m	Expected long-term rate of return at 31 December 2001 % pa
Market values of scheme assets:		
Equities	**7,779**	**8.0**
Fixed interest securities	**1,835**	**5.1**
Property	**798**	**7.1**
Other	**714**	**4.1**
Total fair value of scheme assets	**11,126**	

The following amounts at 31 December 2001 were measured in accordance with the requirements of FRS 17:

	£m
Market value of assets	**11,126**
Present value of scheme liabilities	**(10,618)**
Surplus in the schemes	**508**
Related deferred tax liability	**(152)**
Net pension asset	**356**

If these amounts had been recognised in the financial statements, the Group's net assets and profit and loss account reserve at 31 December 2001 would have been as follows:

	£m
Net assets excluding net pension asset	**10,168**
Net pension asset	**356**
Net assets including net pension asset	**10,524**
Profit and loss reserve excluding net pension asset	**7,455**
Net pension asset	**356**
Profit and loss reserve including net pension asset	**7,811**

46 Contingent liabilities and commitments

a Contingent liabilities and commitments arising out of banking transactions	**2001 £m**	2000 £m
Contingent liabilities:		
Acceptances and endorsements	**2,243**	357
Guarantees	**3,789**	3,249
Other:		
Other items serving as direct credit substitutes	**460**	266
Performance bonds and other transaction-related contingencies	**1,469**	1,271
Other contingent liabilities	**2**	4
	1,931	1,541
	7,963	5,147
Commitments:		
Documentary credits and other short-term trade-related transactions	**354**	238
Forward asset purchases and forward forward deposits placed	**783**	779
Undrawn note issuing and revolving underwriting facilities	**35**	53
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year maturity	**42,594**	33,815
1 year or over maturity	**9,576**	7,701
Commitments arising out of sale and option to resell transactions	**–**	3
	53,342	42,589

46 Contingent liabilities and commitments (continued)

b Limited voting ordinary shares (see note 42)

The limited voting ordinary shares are held by the Lloyds TSB Foundations for England & Wales, Scotland, Northern Ireland and the Channel Islands; these shares do not carry any entitlement to dividends. Lloyds TSB Group plc has entered into deeds of covenant with the four foundations, under the terms of which Lloyds TSB Group plc makes annual donations to the foundations equal, in total, to 1% of the Group's pre-tax profits (after certain adjustments) averaged over three years. The deeds of covenant can be cancelled by the Group at nine years' notice.

c Guaranteed annuity options

After an extensive review of its existing practices carried out in the light of the judgement of the House of Lords in the guaranteed annuities case *Equitable Life vs Hyman*, it was announced that Scottish Widows was revising the way it calculates benefits for guaranteed annuity policies with effect from 1 February 2002. As a result of this change, the terminal bonuses for guaranteed annuity option policies will be increased.

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. This Account had a value at 31 December 2001 of approximately £1.7 billion, and is available to meet any additional costs of providing guaranteed benefits on transferred policies, including guaranteed annuity option policies. The assets allocated to the Additional Account include certain hedge assets, to provide protection to the With Profits Fund against the consequences of a future fall in interest rates.

The eventual cost of providing the enhanced benefits is dependent upon a number of factors, including in particular:

- The proportion of policyholders with a guaranteed annuity option policy who choose to exercise their options;
- The effect of future interest rate and mortality trends on the cost of annuities; and
- The future investment performance of the With Profits Fund.

Having considered a range of possible outcomes, the Group currently expects that the most likely outcome is that the balance in the Additional Account available for this purpose will be sufficient to meet the cost of the enhanced benefits payable to the guaranteed annuity option policyholders, as well as other contingencies. This cost, currently estimated to be approximately £1.4 billion, will be paid out over many years as policies mature. In the event that the amount in the Additional Account proves, over time, to be insufficient, the shortfall will be met by the Group. At this time, no provision is considered necessary for such risk.

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 33 to 39 in the financial review.

a Derivatives

The Group uses derivatives as part of its trading activities and to reduce its own exposure to fluctuations in interest and exchange rates.

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 2001	Notional principal amount £m	Fair values Assets £m	Fair values Liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	**95,895**	**1,035**	**1,038**
Currency swaps	**6,737**	**223**	**152**
Options purchased	**3,825**	**11**	**–**
Options written	**3,492**	**–**	**9**
	109,949	**1,269**	**1,199**
Interest rate contracts:			
Interest rate swaps	**286,617**	**4,085**	**4,535**
Forward rate agreements	**54,171**	**78**	**84**
Options purchased	**8,887**	**73**	**–**
Options written	**3,993**	**–**	**58**
Futures	**35,112**	**–**	**–**
	388,780	**4,236**	**4,677**
Equity contracts	**4,580**	**428**	**255**
Effect of netting		**(3,843)**	**(3,843)**
Balances arising from off-balance sheet financial instruments		**2,090**	**2,288**

31 December 2000	Notional principal amount £m	Fair values Assets £m	Fair values Liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	86,423	1,742	1,940
Currency swaps	6,049	304	206
Options purchased	1,208	23	–
Options written	1,023	–	19
	94,703	2,069	2,165
Interest rate contracts:			
Interest rate swaps	290,129	3,484	3,438
Forward rate agreements	48,002	57	64
Options purchased	3,539	17	–
Options written	2,229	–	8
Futures	34,390	6	–
	378,289	3,564	3,510
Equity contracts	2,768	443	59
Effect of netting		(3,388)	(3,388)
Balances arising from off-balance sheet financial instruments		2,688	2,346

47 Derivatives and other financial instruments (continued)

a Derivatives (continued)

Non-trading

Through intra company and intra group transactions the Group establishes non-trading derivatives positions with the Group's independent trading operations. Similar positions are also established with third parties. The notional principal amounts and fair values of non-trading instruments entered into with third parties were as follows:

31 December 2001	Notional principal amount £m	Fair values Positive £m	Fair values Negative £m
Exchange rate contracts:			
Spot, forwards and futures	**146**	**3**	**1**
Currency swaps	**70**	**9**	**1**
	216	**12**	**2**
Interest rate contracts:			
Interest rate swaps	**2,919**	**164**	**68**
Forward rate agreements	**62**	**–**	**–**
	2,981	**164**	**68**
Effect of netting		**(39)**	**(39)**
		137	**31**

31 December 2000	Notional principal amount £m	Fair values Positive £m	Fair values Negative £m
Exchange rate contracts:			
Spot, forwards and futures	296	4	4
Currency swaps	78	5	7
	374	9	11
Interest rate contracts:			
Interest rate swaps	2,466	96	35
Forward rate agreements	134	–	–
	2,600	96	35
Effect of netting		–	–
		105	46

The Company held non-trading derivatives with a notional principal amount of £400 million (2000: £400 million).

The aggregate carrying value of non-trading derivatives with a positive fair value was an asset of £18 million (2000: an asset of £23 million) and with a negative fair value was an asset of £1 million (2000: a liability of £1 million).

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

31 December 2001	Under 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
Exchange rate contracts:				
Notional principal amount	**102,130**	**6,260**	**1,775**	**110,165**
Net replacement cost	**663**	**132**	**42**	**837**
Interest rate contracts:				
Notional principal amount	**187,570**	**155,079**	**49,112**	**391,761**
Net replacement cost	**545**	**229**	**188**	**962**
Equity contracts:				
Notional principal amount	**738**	**3,394**	**448**	**4,580**
Net replacement cost	**75**	**330**	**23**	**428**
Total:				
Notional principal amount	**290,438**	**164,733**	**51,335**	**506,506**
Net replacement cost	**1,283**	**691**	**253**	**2,227**
31 December 2000				
Exchange rate contracts:				
Notional principal amount	88,288	4,973	1,816	95,077
Net replacement cost	1,094	183	39	1,316
Interest rate contracts:				
Notional principal amount	177,684	159,422	43,783	380,889
Net replacement cost	731	146	157	1,034
Equity contracts:				
Notional principal amount	506	2,054	208	2,768
Net replacement cost	68	343	32	443
Total:				
Notional principal amount	266,478	166,449	45,807	478,734
Net replacement cost	1,893	672	228	2,793

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.

	2001 £m	2000 £m
OECD banks	**1,425**	2,244
Other	**802**	549
Net replacement cost	**2,227**	2,793
Qualifying collateral held	**(339)**	(643)
Potential credit risk exposure	**1,888**	2,150

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.

As at 31 December 2001	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	**2,709**	**37**	**26**	**4**	**6**	**–**	**1,630**	**4,412**
Loans and advances to banks	**11,311**	**1,621**	**1,076**	**142**	**289**	**452**	**333**	**15,224**
Loans and advances to customers	**74,361**	**5,252**	**8,798**	**28,497**	**7,108**	**(1,353)**	**272**	**122,935**
Debt securities and equity shares	**2,545**	**1,662**	**718**	**1,940**	**4,168**	**(6)**	**13,423**	**24,450**
Other assets	**154**	**9**	**8**	**4**	**15**	**17,291**	**5,648**	**23,129**
Total assets	**91,080**	**8,581**	**10,626**	**30,587**	**11,586**	**16,384**	**21,306**	**190,150**
Liabilities:								
Deposits by banks	**19,226**	**1,859**	**666**	**512**	**90**	**681**	**1,276**	**24,310**
Customer accounts	**92,834**	**1,644**	**1,172**	**3,228**	**2,299**	**7,633**	**306**	**109,116**
Debt securities in issue	**16,453**	**3,957**	**1,333**	**600**	**890**	**–**	**1,187**	**24,420**
Other liabilities	**350**	**–**	**3**	**–**	**5**	**7,180**	**5,352**	**12,890**
Subordinated liabilities – loan capital	**1,069**	**714**	**–**	**641**	**5,233**	**–**	**–**	**7,657**
Minority interests and shareholders' funds	**–**	**–**	**–**	**–**	**–**	**11,655**	**102**	**11,757**
Internal funding of trading business	**(3,736)**	**(741)**	**(1,171)**	**(6,051)**	**(1,384)**	**–**	**13,083**	**–**
Total liabilities	**126,196**	**7,433**	**2,003**	**(1,070)**	**7,133**	**27,149**	**21,306**	**190,150**
Off-balance sheet items	**21,937**	**(10,861)**	**(7,509)**	**(2,896)**	**(671)**	**–**	**–**	**–**
Interest rate repricing gap	**(13,179)**	**(9,713)**	**1,114**	**28,761**	**3,782**	**(10,765)**	**–**	**–**
Cumulative interest rate repricing gap	**(13,179)**	**(22,892)**	**(21,778)**	**6,983**	**10,765**	**–**	**–**	**–**

As at 31 December 2000*	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	534	40	46	9	1	–	1,079	1,709
Loans and advances to banks	13,034	1,184	392	112	191	185	192	15,290
Loans and advances to customers	69,150	4,206	6,109	30,673	5,542	(1,378)	130	114,432
Debt securities and equity shares	2,497	475	464	1,202	1,747	51	8,416	14,852
Other assets	251	22	47	5	22	16,603	4,795	21,745
Total assets	85,466	5,927	7,058	32,001	7,503	15,461	14,612	168,028
Liabilities:								
Deposits by banks	12,854	1,090	604	396	92	789	910	16,735
Customer accounts	89,194	1,955	1,508	2,506	394	6,141	291	101,989
Debt securities in issue	8,519	5,950	1,769	623	82	–	956	17,899
Other liabilities	159	–	3	91	2	8,289	4,775	13,319
Subordinated liabilities – loan capital	1,727	509	–	637	4,637	–	–	7,510
Minority interests and shareholders' funds	–	–	–	–	–	10,556	20	10,576
Internal funding of trading business	148	(982)	(264)	(6,188)	(374)	–	7,660	–
Total liabilities	112,601	8,522	3,620	(1,935)	4,833	25,775	14,612	168,028
Off-balance sheet items	12,229	(766)	170	(10,612)	(1,021)	–	–	–
Interest rate repricing gap	(14,906)	(3,361)	3,608	23,324	1,649	(10,314)	–	–
Cumulative interest rate repricing gap	(14,906)	(18,267)	(14,659)	8,665	10,314	–	–	–

The table above 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).

*restated (see note 1)

47 Derivatives and other financial instruments (continued)

c Fair value analysis

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.

As at 31 December 2001	Trading book		Non-trading book	
Assets:	Book value £m	Fair value £m	Book value £m	Fair value £m
Treasury bills and other eligible bills	**1,630**	**1,630**	**2,782**	**2,780**
Loans and advances to banks and customers	**605**	**605**	**137,554**	**138,287**
Debt securities and equity shares	**13,423**	**13,423**	**11,027**	**11,269**
Liabilities:				
Deposits by banks and customers	**1,582**	**1,582**	**131,844**	**131,813**
Debt securities in issue	**1,187**	**1,187**	**23,233**	**23,266**
Subordinated liabilities	**–**	**–**	**7,657**	**8,084**

As at 31 December 2000*	Trading book		Non-trading book	
Assets:	Book value £m	Fair value £m	Book value £m	Fair value £m
Treasury bills and other eligible bills	1,079	1,079	630	627
Loans and advances to banks and customers	322	322	129,400	130,300
Debt securities and equity shares	8,416	8,416	6,436	6,916
Liabilities:				
Deposits by banks and customers	1,201	1,201	117,523	117,369
Debt securities in issue	956	956	16,943	16,982
Subordinated liabilities	–	–	7,510	7,692

*restated (see note 1)

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 cashflows 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 New Zealand, the Americas and Europe. Details of the Group's structural foreign currency exposures are as follows:

Functional currency of Group operation	**2001 £m**	2000 £m
New Zealand dollar	**748**	703
Euro (and component former currencies)	**286**	289
US dollar	**147**	194
Swiss franc	**104**	120
Other non-sterling	**438**	397
Total	**1,723**	1,703

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 36 and 37 in the financial review.

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.

At 31 December 2001, the unrecognised gains on financial instruments used for hedging were £242 million (2000: £200 million) and unrecognised losses were £820 million (2000: £457 million).

The net losses arising in 2000 and earlier years and recognised in 2001 amounted to £88 million. Net losses of £403 million arose in 2001 but were not recognised in the year.

Of the net losses of £578 million at 31 December 2001, £342 million of net losses are expected to be recognised in the year ending 31 December 2002 and £236 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 36 in the financial review.

48 Acquisitions

On 21 November 2001 the Group's subsidiary, Lloyds TSB Commercial Finance Limited, acquired the issued share capital of CashFriday Limited, a provider of funding and payroll services to the UK temporary recruitment sector. The consideration was approximately £10 million, satisfied by £1 million of cash and the issue of £9 million of short-term loan notes. The premium on acquisition of £8 million has been capitalised and will be written off to the profit and loss account over its estimated useful life of 20 years. There were no fair value adjustments made to the assets acquired. The results of this business have been consolidated in full from the date of acquisition, the effect on the results of the Group is not material.

49 Consolidated cash flow statement

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

	2001 £m	2000* £m
Operating profit	**3,521**	3,857
Increase in prepayments and accrued income	**(411)**	(121)
(Decrease) increase in accruals and deferred income	**(439)**	830
Provisions for bad and doubtful debts	**747**	541
Net advances written off	**(691)**	(580)
General insurance claims	**174**	142
General insurance claims paid	**(178)**	(146)
Amounts written off fixed asset investments	**60**	32
Income from long-term assurance business	**(193)**	(615)
Transfer from long-term assurance business	**155**	104
Interest on subordinated liabilities (loan capital)	**493**	490
Interest element of finance lease rental payments	**1**	1
Depreciation and amortisation	**550**	386
Other non-cash movements	**(395)**	(266)
Net cash inflow from trading activities	**3,394**	4,655
Net increase in loans and advances	**(9,340)**	(6,350)
Net increase in investments other than investment securities	**(5,664)**	(355)
Net increase in other assets	**(327)**	(124)
Net increase (decrease) in deposits by banks	**7,689**	(2,794)
Net increase in customer accounts	**7,525**	7,469
Net increase in debt securities in issue	**6,557**	4,738
Net increase in other liabilities	**109**	185
Net increase in items in course of collection/transmission	**(17)**	(126)
Other non-cash movements	**1**	176
Net cash inflow from operating activities	**9,927**	7,474

b Analysis of cash as shown in the balance sheet

	2001 £m	2000 £m
Cash and balances with central banks	**1,240**	1,027
Loans and advances to banks repayable on demand	**2,443**	2,794
	3,683	3,821

The Group is required to maintain balances with the Bank of England which, at 31 December 2001, amounted to £156 million (2000: £142 million).

c Analysis of changes in cash during the year

	2001 £m	2000 £m
At 1 January	**3,821**	2,408
Net cash (outflow) inflow before adjustments for the effect of foreign exchange movements	**(100)**	1,406
Effect of foreign exchange movements	**(38)**	7
At 31 December	**3,683**	3,821

d Analysis of changes in financing during the year

	Share capital (including premium and merger reserve) 2001 £m	2000 £m
At 1 January	**2,334**	2,136
Cash inflow from financing	**379**	198
At 31 December	**2,713**	2,334

	Capital securities issued by subsidiary undertakings 2001 £m	2000 £m
At 1 January	**515**	–
Effect of foreign exchange movements	**(11)**	6
Cash inflow from financing	**456**	509
At 31 December	**960**	515

	Subordinated liabilities and finance leases 2001 £m	2000 £m
At 1 January	**7,533**	6,497
Effect of foreign exchange movements	**(8)**	120
Cash inflow from financing	**155**	897
Capital repayments	**(20)**	(4)
Adjustments on acquisition	**–**	23
At 31 December	**7,660**	7,533

e Analysis of the net cash outflow in respect of the acquisition of group undertakings

	2001 £m	2000 £m
Cash consideration paid (see f)	**1**	5,110
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	**179**	–
Net cash outflow	**180**	5,110

f Acquisition of group undertakings

	2001 £m	2000 £m
Net assets acquired:		
Loans and advances	**–**	2,827
Long-term assurance business	**–**	4,052
Other assets	**15**	168
Tangible fixed assets	**–**	375
Deposits by banks, customer accounts and other liabilities	**(13)**	(3,239)
	2	4,183
Goodwill arising on consolidation	**8**	2,405
	10	6,588
Satisfied by:		
Issue of loan notes	**9**	1,077
Cash	**1**	5,110
Payments pending settlement	**–**	401
	10	6,588

g Disposal of group undertakings and businesses

	2001 £m	2000 £m
Net assets disposed of:		
Sundry net assets	**1**	2
Goodwill written back on disposal	**–**	93
	1	95
Profit (loss) on sale	**39**	(12)
Cash consideration received	**40**	83

*restated (see note 1)

information for **shareholders**

analysis of shareholders

at 31 December 2001

Size of shareholding	Shareholders		Number of ordinary shares	
	Number	%	Millions	%
1 – 99	66,429	6.77	2.0	0.04
100 – 499	464,122	47.33	157.1	2.82
500 – 999	290,870	29.68	182.7	3.28
1,000 – 4,999	123,357	12.58	239.0	4.30
5,000 – 9,999	18,968	1.93	130.3	2.34
10,000 – 49,999	14,034	1.43	256.3	4.61
50,000 – 99,999	893	0.09	61.3	1.10
100,000 – 999,999	1,357	0.14	442.4	7.95
1,000,000 and over	483	0.05	4,093.2	73.56
	980,513	100.00	5,564.3*	100.00

Includes 813 million shares (14.6%) registered in the names of some 855,000 individuals. 200 million shares (3.6%) are held by over 63,000 staff and Group pensioners, or on their behalf by the trustee of the staff profit sharing schemes.

Substantial shareholdings

No notification has been received that anyone has an interest in 3% or more of the nominal value of the issued share capital.

Share price information

In addition to information published in the financial pages of the press, the latest price of Lloyds TSB shares on the London Stock Exchange can be obtained by telephoning 0906 8771515. These telephone calls are charged at 60p per minute, including VAT.

Share dealing facilities

The Company provides a low cost, execution only, postal dealing service for the purchase and sale of Lloyds TSB shares through Lloyds TSB Registrars. The current rate of commission for purchases is 0.75%, minimum £10, and for sales is 0.75%, no minimum. For full details please contact Lloyds TSB Registrars. Telephone 0870 6060302.

The Company also provides a telephone dealing service through Lloyds TSB Stockbrokers for the purchase and sale of Lloyds TSB shares on preferential commission terms. The current rate for both purchases and sales is 0.75%, minimum £18.50 maximum £75, for transactions up to £75,000. For full details please contact Lloyds TSB Stockbrokers. Telephone 0845 7888100.

American Depositary Receipts (ADRs)

Lloyds TSB shares are traded in the USA through an NYSE-listed sponsored ADR facility, with The Bank of New York as the depositary. The ADRs are traded on the New York Stock Exchange under the symbol LYG. The CUSIP number is 539439109 and the ratio of ADRs to ordinary shares is 1:4. For details please contact The Bank of New York, Investor Relations, PO Box 11258, Church Street Station, New York, NY 10286-1258. Telephone (1) 888 BNY ADRS (US toll free), international callers (1) 610 312 5315. Email Shareowner–svcs@bankofny.com

Individual Savings Accounts (ISAs)

The Company provides a facility for investing in Lloyds TSB shares through an ISA. For details please contact Lloyds TSB Private Banking ISAs, Freepost, PO Box 149, Haywards Heath, West Sussex RH16 3BR. Telephone 0845 7418418.

The community and our business

Information about the Group's role in the community and copies of the Group's code of business conduct and its environmental report may be obtained by writing to Public Affairs, Lloyds TSB Group plc, 71 Lombard Street, London EC3P 3BS. This information is also available on the Group's website (see below).

The Better Payment Practice Code

A copy of the code and information about it may be obtained from: The Department of Trade and Industry, 1 Victoria Street, London SW1H 0ET.

Shareholder enquiries

The Company's share register is maintained by Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA. Telephone 0870 6003990; textphone 0870 6003950. Please contact them if you have enquiries about your Lloyds TSB shareholding, including those concerning the following matters:

- change of name or address
- loss of share certificate, dividend warrant or tax voucher
- to obtain a form for dividends to be paid directly to your bank or building society account (tax vouchers will still be sent to your registered address unless you request otherwise)
- to obtain details of the dividend reinvestment plan which enables you to use your cash dividends to buy Lloyds TSB shares in the market
- request for copies of the report and accounts in alternative formats for shareholders with disabilities.

Lloyds TSB Registrars operates a web based enquiry and portfolio management service for shareholders. Visit www.shareview.co.uk for details.

financial calendar 2002

15 February
Results for 2001 announced

27 February
Ex-dividend date for 2001 final dividend

1 March
Record date for final dividend

3 April
Final date for joining or leaving the dividend reinvestment plan for the final dividend

17 April
Annual general meeting in Edinburgh

1 May
Final dividend paid

2 August
Results for half-year to 30 June 2002 announced

14 August
Ex-dividend date for 2002 interim dividend

16 August
Record date for interim dividend

11 September
Final date for joining or leaving the dividend reinvestment plan for the interim dividend

9 October
Interim dividend paid

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Lloyds TSB Group

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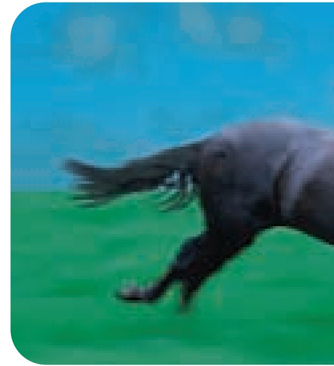

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