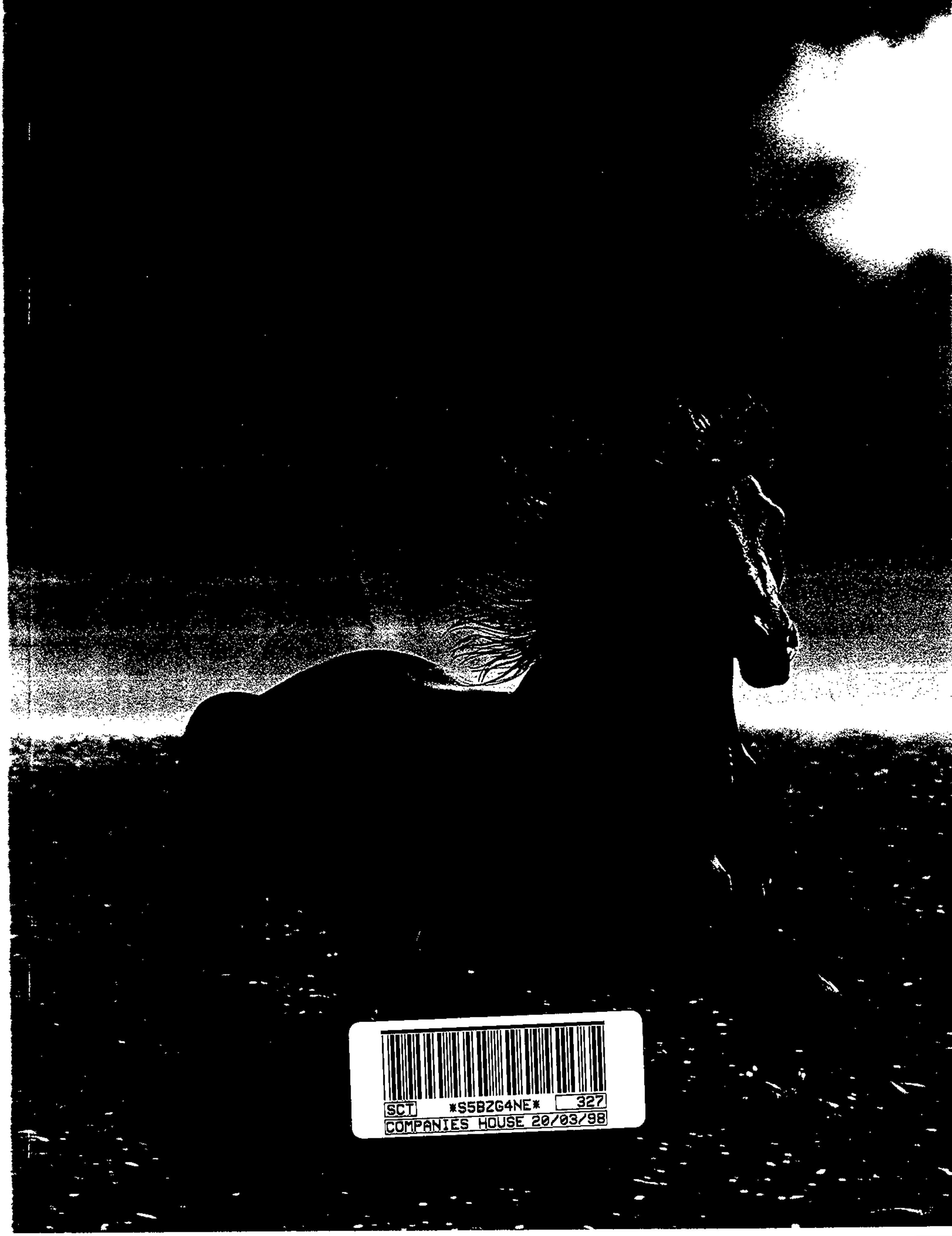
Lloyds TSB Group plc **Annual Report and Accounts 1997**



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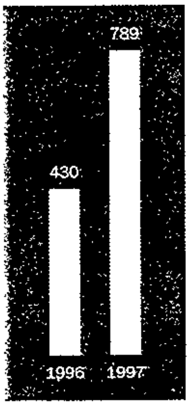
Highlights of the year

Lloyds TSB *is a leading UK-based financial services group, whose businesses provide a comprehensive range of banking and financial services in the UK and overseas. At the end of 1997 total group assets were £158 billion and there were over 82,500 employees. Market capitalisation was £42.6 billion. The Group's shares are held by over 1 million shareholders.*

Share price (year-end) pence



The Group's share price increased by 83% to 789p per share at 31 December 1997

Group profit before tax
up 26% to £3,162 million from £2,505 million in 1996

Earnings per share from ongoing businesses
up 26% to 39.4p per share

Post-tax return on shareholders' equity
increased to 40.8% (ongoing businesses 36.8%)

Operating expenses
reduced by 5%

Cost:income ratio
improved significantly to 50.4% from 57.0%

Retail Financial Services
profit up £301 million, or 17%, to £2,054 million, representing 65% of total group profit

Shareholders' funds
grew by £1.180 million, or 23%, to £6,254 million

Capital base
total capital ratio 10.8%, tier 1 ratio 7.9%

Dividends
a final dividend of 11.9p per share is recommended, payable on 1 May 1998. This makes a total for 1997 of 17.2p, an increase of 30%

Total return to shareholders
(share price appreciation plus dividends) 87%

TSB

Cheltenham & Gloucester

Chairman's statement

Our aim is to be the best and most successful company in the financial services industry, a leader in our chosen markets

A changing environment

There was a time when banking was the business of accepting deposits, granting loans and getting the money back safely. Change was gradual; the banker stuck to his last; and competition from other institutions was modest. Today, banking is in ferment; the lines between the activities of the different financial institutions become increasingly blurred; and we are finding it harder and harder to define a bank.

Competition, deregulation and technology are changing the shape of the financial services business. Markets are open. Barriers to entry are coming down. New competitors are arriving from all directions. Conventional banks, with their high cost structures, are finding themselves at a disadvantage against competitors who have much lower distribution and delivery costs. And low inflation and Economic and Monetary Union are further new ingredients in the melting pot. After years sheltered from the full rigour of market competition, the challenge confronting bankers is how to survive and prosper in a fiercely competitive market for financial services.

This transformation of the financial services market is happening all over the world. Overcapacity has increased after deregulation, as new competitors have come in and existing companies have expanded into new markets. The amount of capital and human resources injected into the industry has often greatly exceeded the growth potential in those markets. The question is not whether restructuring of the industry is necessary, but how it should be achieved.

Our strategy

The constant challenge of any business is to secure and sustain competitive advantage. In a highly competitive environment, the last thing we want to do is to spread our resources too thinly and with unnecessary risk over too many activities. We continue to believe that tomorrow's most successful banks will be built on focus, not diversity. This requires us to concentrate on the things we do well and then strive to do them better than anybody else.

Sir Brian Pitman, Chairman, with stockbrokers' analysts.

Our aim is to be a leader in our chosen markets and, over recent years, the acquisition of Lloyds Abbey Life and Cheltenham & Gloucester and the merger between Lloyds Bank and TSB have greatly enhanced our leadership positions. Our emphasis on leadership also means that we will continue to seek opportunities to strengthen our hand in markets and products where we already have a solid position. Where we are not a leader, or where we cannot aspire reasonably to leadership, our course will be to divest and capture the value for shareholders. We would rather be a leader in a few markets than a minor participant in many. In 1997, we divested activities, which no longer fit our strategy, and made an aggregate profit of £154 million from the disposal proceeds.

1997 financial results

1997 was a successful year for the Lloyds TSB Group. Even as we went about the complex and demanding task of integrating two large financial institutions, we again produced record results. Each of the principal business units improved its performance.

Total revenue grew to £7,230 million, up by 7 per cent. The trading surplus increased by 22 per cent to £3,554 million. Earnings per share from ongoing businesses rose to 39.4p, up by 26 per cent. Group economic profit rose by 61 per cent to £1,762 million. This strong performance has enabled the board to recommend a dividend of 17.2p for the year, an increase of 30 per cent.

Shareholder value

1997 was another good year for our shareowners. The share price rose by 83 per cent, compared with an increase of 20 per cent in the FTSE All Share Index. Taking share price appreciation and dividend income together, the total return to shareowners was 87 per cent.

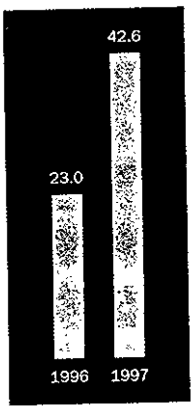
Looking at the predecessor quoted companies, an investment of £1,000 in Lloyds Bank shares ten years ago, with dividends reinvested, would be worth over £21,000 at the end of 1997. On the same basis, an investment of £1,000 in TSB shares would be worth almost £15,000, while an investment of £1,000 in the FTSE All Share Index would be worth £4,300.

In pursuit of our aim of maximising shareholder value, we use a system of value based management as a framework for making business decisions; and we choose economic profit as a measurement of performance because it captures both growth in investment and return. Broadly defined, it represents the difference between the earnings on the equity invested in a business and the cost of the equity.

Everything we do starts with an evaluation of economic profit, because it helps us to think long term. We make a multi-year assessment, not a single year assessment.

Maximising shareholder value – by dividend increases and by share price appreciation – remains our governing objective

Market capitalisation (year-end) £bn



In 1997 market capitalisation increased by £19.6 billion, or 85%, to £42.6 billion

Today, economic profit drives our management decisions. It has helped us build a £40 billion enterprise with earnings driven by new products, new delivery systems, acquisitions, selective divestments and a more focused and motivated management team.

Lloyds TSB and its stakeholders

Our aim is to be the best and most successful company in the financial services industry, measured by our success in creating value over time. Focusing on maximising value over the long haul helps us to avoid short-termism. If we are to create value for our owners over the long haul, we must also create value for our customers, our staff and all other stakeholders over the long haul.

Since the merger between Lloyds Bank and TSB two years ago, the new Lloyds TSB Group has created over £25 billion of shareowner wealth. Among our 1 million shareowners are over 50,000 group staff and pensioners, many pension funds, university endowments, charities and other non-profit organisations. If we are successful at creating value, our shareowners have more to give. There is a beneficial ripple effect throughout society.

A successful business cannot operate in isolation from the community of which it is a part. Our staff, our customers, our suppliers, our shareowners, live and work in local communities. We are an integral part of those communities and we encourage our people to take an active part in the communities which we serve.

So, we need to create wealth because it is good for us. It enables us to invest in the future, in new facilities and improved customer service. The taxes levied on wealth creation help to pay for state services – for education and health, for pensions and social security. Wealth creation is good for the country and the government. No company can survive for long unless it creates wealth.

Lloyds TSB Group is one of the biggest charitable givers in the UK and one of the biggest investors in the community. The Lloyds TSB Foundations will receive some £21 million for distribution in 1998. We can only do this because we are one of the biggest wealth creators in the UK.

There is no conflict between wealth creation and social progress: each is necessary for the other. Over time, maximising shareholder value will produce the highest level of benefits for all stakeholders.

Staff

One of the greatest competitive advantages we have is the ability of our people successfully to adapt to rapid change.

The integration of Lloyds Bank, TSB, Cheltenham & Gloucester and Lloyds Abbey Life has brought massive change but, rather than the resistance which might have been expected, what we have seen has been the great willingness of our people to embrace change. Their enthusiasm and dedication are at the heart of our success.

Recognising that contribution, in 1997 the board approved profit sharing of £102 million, which means an average payment of £1,600, or 10.5 per cent of basic salary, to each member of our staff eligible to participate in the scheme.

Board changes

John Davies, Deputy Chairman, retires at the end of July, after a distinguished career with the Group spanning 49 years. He will be succeeded by Alan Moore, who retires as Deputy Group Chief Executive and Treasurer on 30 April. Michael Fairey will become Deputy Group Chief Executive on 1 March.

Gordon Pell and David Pritchard will join the board as executive directors on 1 March and 1 April respectively.

Another three directors will be leaving the board at the annual general meeting: Andrew Longhurst, Chairman and, until 1996, Chief Executive of Cheltenham & Gloucester; Sir Michael Quinlan, who joined the board of Lloyds Bank in 1992; and John Raisman, who joined the board of Lloyds Bank in 1985.

We greatly appreciate the contribution to the Group made by all these retiring directors.

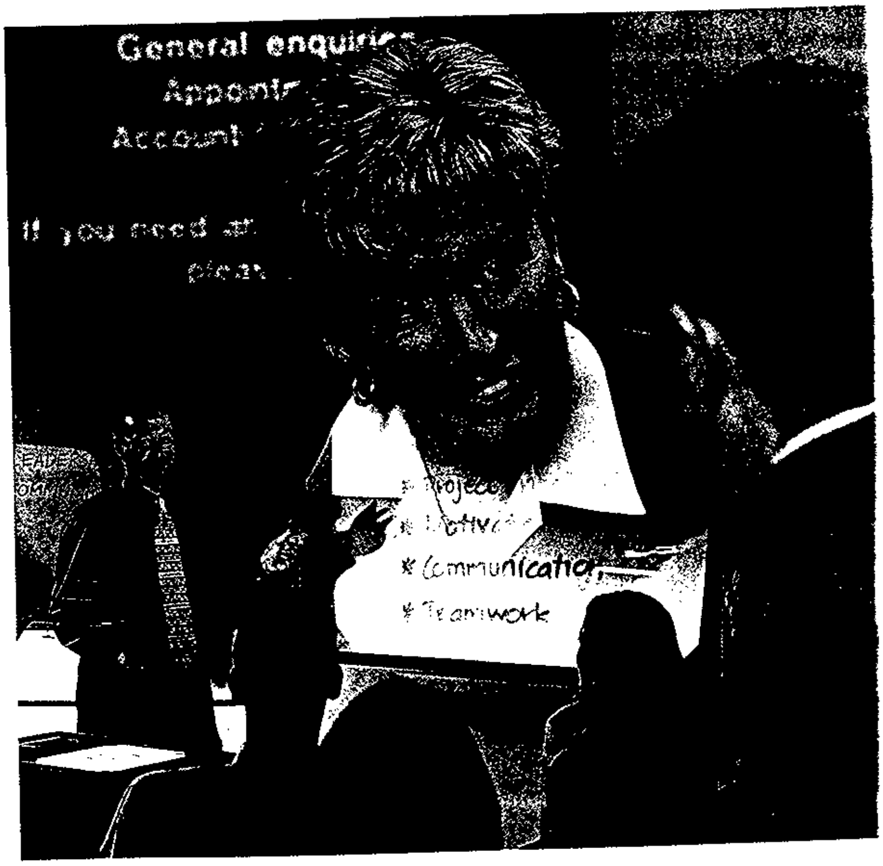
Outlook

Measured by both growth in equity and return, 1997 was a very good year for the Lloyds TSB Group and the momentum continued in the second half of the year, with earnings per share from ongoing businesses up by 13 per cent on the first half.

Although in 1998 we expect a slowdown in both the world and the UK economies, we remain confident about our ability to continue to produce superior returns for shareowners.

Brian Pitman

Sir Brian Pitman
Chairman



We seek to understand and meet our customers' needs more effectively than any of our competitors. We can only do this with well-trained, focused and committed staff.

Group Chief Executive's review

Our strategic aims

Our governing objective is to maximise shareholder value. To achieve that objective we have to fulfil three strategic aims. First, we aim to be a leader in our chosen markets. Second, we aim to be first choice for our 15 million customers by understanding and meeting their needs more effectively than our competitors. Third, we aim to reduce day-to-day operating costs through increased efficiency, so that we can make further investments in the company in terms of better products and improved service.

Progress has been made in all these areas. During 1997 we sold businesses in which we had either decided not to seek market leadership, or businesses which were duplicated following the merger.

Peter Ellwood, Group Chief Executive, with staff who have won gold awards for [illegible]

Being first choice for our customers was manifested in a number of new product launches, the use of new delivery channels, and by an improvement in customer service.

Reducing day-to-day operating expenses was an area where we made good progress and our cost to income ratio is now 50.4 per cent compared to 60 per cent at the time of the merger in 1995. In the last two years we have achieved cost savings of some £220 million towards our target of cost savings of at least £400 million per annum by the end of 1999.

None of this progress could have been made without the hard work and professionalism of our staff, who have managed change so effectively, and I take this opportunity to say thank you to each and every one of them.

Financial results

So how did the implementation of these strategic themes translate into financial results? Group profit before tax rose by 26 per cent to a record £3,162 million. Perhaps the most encouraging aspect of the year was that income grew by 7 per cent, with volumes and overall margins both holding up well, and costs were 5 per cent lower than they were in 1996. It will always be easier for us to manage costs rather than income, which is determined to a great extent by market forces, and we expect that growing quality income will be more challenging over the coming years as competitors become more aggressive.

Retail Banking

Profit before tax from Retail Banking rose by 16 per cent to £832 million, reflecting increased volumes and tight cost control. Personal loans and credit card lending grew by 13 per cent and there was good growth in current account balances, savings and investments. We have increased our share of small business accounts, and private banking and retail stockbroking have prospered from higher volumes.

Initiatives during the year include the launch of the new Lloyds Bank Gold Service Current Account and TSB Select Account, both offering an attractive range of features representing improved value for money for our customers, and C&G's new Instant Transfer Account has been particularly successful in attracting deposits. We have started a trial of a small number of branch co-locations, which involves bringing together a branch of Lloyds Bank and a branch of TSB in the same premises. We are also setting up a number of new style branches and insurance shops in ASDA stores, and we have signed an agreement with the Post Office that will allow many Lloyds TSB customers to use selected post offices around the country where distances make access to one of our branches more difficult.

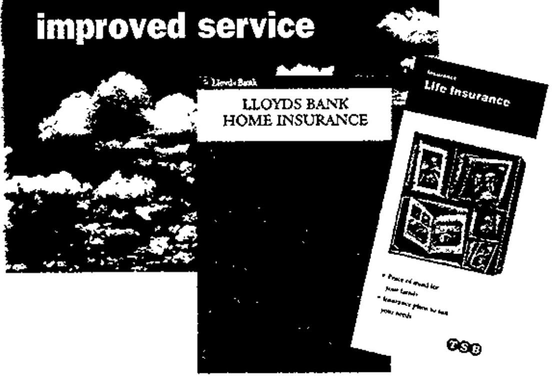
Our telephone banking operations continue to expand; over 800,000 customers have now registered to use these services, and in 1997 Telephone Banking handled over 15 million calls, making Lloyds TSB one of the largest telephone banks in the UK. We have launched PhoneBank Express, which uses state-of-the-art technology to recognise speech commands given by customers, the first of its kind in Europe. Customer enquiries are increasingly being answered through call centres, and telemarketing is a successful source of new business. We continue to develop PC and Internet banking and Internet accessibility for our customers, and a pilot is running in Hull testing customer experience with TV banking that will allow access to account information and some basic transactions using a home television. All these initiatives are part of our ongoing desire to offer easier access for our customers to our wide range of banking products and services.

Mortgages

Pre-tax profit from Mortgages grew by 33 per cent to £693 million. Although there has been some improvement in the housing market and in property prices, competition for mortgages has remained strong.

Mortgages are now the Group's largest product line, with Cheltenham & Gloucester (C&G), one of the UK's leading mortgage brands, selling mortgages through C&G and Lloyds Bank branches and, since the third quarter of 1997, also through TSB branches in England and Wales. In 1997 we gained 11.4 per cent market share of net new mortgage lending. With total mortgages outstanding at the end of the year of £41.8 billion to over 900,000 borrowers, the Group is the third largest mortgage lender in the UK, with a market share of 9.6 per cent.

We aim to reduce day-to-day operating costs so that we can invest further in better products and improved service



In May we sold Mortgage Express at a profit of £52 million, as this kind of third party introduced business does not fit with our mortgage strategy.

Insurance

During the year we brought the management of our insurance businesses together under one team and work is progressing well on the integration of these businesses.

Pre-tax profit from Insurance rose by 28 per cent to £642 million, before a charge for pension provisions and one-off tax items. Underlying profit from life and pensions increased by 26 per cent to £418 million. General insurance profit, comprising broking and underwriting, rose by 32 per cent to £224 million. In 1997 we increased the provisions for possible redress to purchasers of pension policies by £100 million, raising the total Group provision made for this purpose to £300 million.

Wholesale Markets

Our Wholesale Markets businesses, which provide banking, treasury and financial services to large and medium-sized companies and banks, increased their profit by 17 per cent to £653 million. Our commercial middle market businesses made excellent progress. Lloyds Development Capital had a good year, realising higher capital gains. Treasury operations also produced good results, despite less favourable market conditions. Although there is continuing strong competition for good quality lending, we were able to improve interest margins in the larger corporate market. Lloyds Bank Registrars maintained its leading market position, winning a substantial proportion of the new business from the demutualisation of former building societies. At the beginning of 1998 we sold International Factors at a profit of £160 million and this transaction will be reflected in the 1998 accounts.

International Banking

International Banking profit rose by 13 per cent to £425 million. Profits were higher in New Zealand and in the international private banking and offshore banking businesses, but were partly offset by weaker results from Brazil. There was also a higher contribution from Emerging Markets Debt. During the year we sold Schröder Münchmeyer Hengst, the German private bank, and we obtained 100 per cent control of Losango Consumer Finance in Brazil.

Our Business Banking managers value close relationships with their customers. Richard Saunders visiting Steve Webber at his cheese dairy in Cheddar.

Merger integration progress

We are making good progress with the merger of Lloyds Bank and TSB. Common businesses have been brought together, head offices and training centres have been combined, and significant cost savings have been achieved. We have harmonised the terms and conditions of employment for staff in Lloyds Bank and TSB, and adopted best practices from each of the separate companies across the Group.

The private bill to bring the businesses of TSB Bank into Lloyds Bank Plc is proceeding through parliament and we anticipate that it will be enacted in a few months' time.

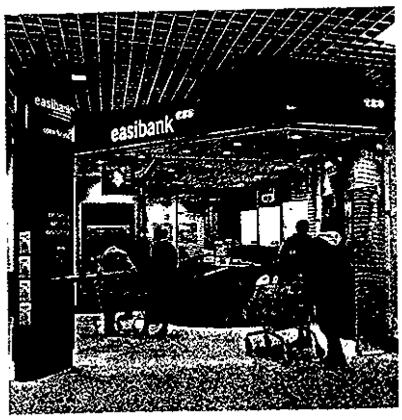
Work continues to ensure that all our systems and business processes will be fully 'year 2000' compliant, and we expect this to be so by November 1998. We have also been preparing for the advent of the single European currency.

Looking ahead

We face increasing competition from both established and new players. Much progress has been made, but more remains to be done. We are in good competitive shape, with a clear strategy, helped by our focus on economic profit. The quality of our earnings is high and we have a strong balance sheet. Further merger benefits are still to come and, despite an increasingly challenging environment, we are well positioned to go on delivering value for our customers, our staff and our shareholders.

Peter Ellwood
Group Chief Executive

During 1997 a number of branches began operating under the Lloyds TSB brand, providing services to Lloyds Bank and TSB customers from single premises.



Our 'easibank' financial centre in ASDA's Lower Earley, Reading hypermarket provides a full range of personal financial services to shoppers.

Lloyds TSB in the community

Our staff, our customers, our suppliers and our shareholders live and work in local communities throughout the UK. That makes us an integral part of those communities.

In 1998 Lloyds TSB will covenant to the four Lloyds TSB Foundations* £21 million for distribution to charities, making the Foundations, in aggregate, one of the largest charitable grant-making bodies in the UK.

The Foundations provide direct support to registered charities throughout the UK, whose activities underpin community life. The aim is to enable people, particularly disabled and disadvantaged people, to play a fuller role in society.

Last year, more than 3,300 charities were awarded grants ranging, for example, from £500 to improve access for disabled people to a museum to £150,000 towards the cost of a foster grandparent programme, which uses the skills and experience of elderly people to support lone parents.

For many community groups, the support given by the Foundations is a lifeline. Peter Gentry of Whipton Community Association said: "Many small charities, like our luncheon club for elderly people, rely on voluntary donations to keep their services running. For many elderly people, our club breaks the isolation they live in. We give our members a proper meal, support and companionship. For many, it's the only thing they have to look forward to all week, and it's Lloyds TSB which makes it possible."

Lunch at the Whipton Community Association.

We encourage our staff to raise funds for local causes through a Matched Giving Scheme run by the Foundations. The Foundations match each fund-raising initiative, up to a certain limit, for eligible projects within their guidelines. Through the Matched Giving Scheme, staff raised nearly £900,000 in 1997.

One charity to benefit was the Kingshurst Family Centre, run by NCH Action for Children, which provides opportunities for parents to develop skills in caring for, playing with and relating to their children. "It was an eye-opener to find that within my locality there is a need for a centre like this, where parents come to develop that basic relationship with their children which most of us take for granted," said Peter Simmons, manager at a Birmingham branch. Peter organised a go-kart rally which raised over £4,500 for the charity. "The staff felt really great at being able to double their money with matched funding to help such an important local facility," he said.

As well as raising money, many of our staff also contribute their experience and expertise to the community where they live and work on a practical level.

The focus of the Group's support is in the field of education where, with their business experience, staff often become school governors. The Group provides a framework of support and training to help around 600 members of staff provide this valuable voluntary service.

Peter Simmons drops in on a parent and toddlers group at the Kingshurst Family Centre.

* *The Lloyds TSB Foundations are four independent grant-making organisations covering England and Wales, Scotland, Northern Ireland and the Channel Islands. They receive, instead of the dividend on their shareholdings, 1 per cent of pre-tax profits of the Group, averaged over 3 years, to distribute to registered charities.*

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

Retail Financial Services encompasses three of the main businesses – Retail Banking, Mortgages and Insurance – which provide a full range of banking and financial services to over 15 million personal and small business customers. With nearly 2,900 branches of Lloyds Bank, TSB and Cheltenham & Gloucester (C&G), the Group has the most comprehensive geographic coverage of any financial services group in England, Scotland and Wales.

Retail Banking. The main businesses included under Retail Banking are:

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

• *Card services.* The Group is a member of both the VISA and MasterCard payment systems and is the second largest bank credit card issuer in the UK with 5.8 million cards in issue and balances outstanding of £2.5 billion at the end of 1997. In addition, 6.5 million debit cards have been issued to customers.

• *ATMs.* With 4,300 automated teller machines (ATMs) at branches and external locations around the country, the Group has the largest cash dispenser network of any banking group in the UK. Personal customers of Lloyds Bank and TSB are able to withdraw cash through the cash dispensers of either bank free of charge. In addition, they have access to a further 18,000 ATMs in the UK and, through the VISA and MasterCard networks, to over 200,000 ATMs worldwide.

• *Telephone Banking.* Telephone Banking continues to grow and the Group is one of the largest telephone banks in the UK. At the end of 1997 over 800,000 customers had registered to use the services of PhoneBank, PhoneBank Express, an automated voice response service, and LloydsLine.

• *Business Banking.* Small business customers have access to a wide range of services through over 500 Lloyds Bank and TSB business centres, Lloyds UDT and the factoring and asset finance companies.

• *Lloyds UDT.* Lloyds UDT is a leading finance house providing leasing, hire purchase, and loan products to the corporate and personal sectors direct, through intermediaries, and through a number of joint ventures. It has particular strengths in motor vehicle finance and asset finance for small and medium-sized companies.

• *Private Banking and Stockbroking.* 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, and insurance and personal equity plan products. At the end of 1997, assets held for private clients totalled £9.6 billion, of which over £6.4 billion is under discretionary management.

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

• *Hill Samuel Asset Management* manages funds for the retail life, pensions and unit trust products distributed through Lloyds Bank and TSB branches, as well as funds for corporate pension schemes, local authorities and other institutions in the UK and overseas. At the end of 1997 funds under management totalled £34 billion.

• *Estate agencies.* The Group's estate agency businesses have been combined under Black Horse Agencies and comprise 371 branches, providing estate agency and related services to owners/occupiers of residential property and distributing Group investment and mortgage products through its financial services arm.

Mortgages. Cheltenham & Gloucester is the Group's specialist residential mortgage provider, selling its mortgages through branches of C&G, Lloyds Bank, and TSB in England and Wales, as well as through the telephone and postal service, C&G Mortgage Direct. The Group is the third largest residential mortgage lender in the UK, with a market share of almost 10 per cent, loans outstanding at the end of 1997 of £41.8 billion and over 900,000 borrowers.

Insurance. The Group has the largest insurance distribution network of any UK banking group.

• *Life assurance, pensions and investments.* These businesses comprise Black Horse Financial Services, TSB Life and Pensions, Abbey Life and Hill Samuel Life Assurance. Life, pensions and unit trust funds under management totalled £20 billion at the end of 1997.

• *General insurance.* General insurance broking and underwriting is conducted through Lloyds Bank Insurance Services, TSB General Insurance and Ambassador Insurance.

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 and Tokyo.

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

• *Corporate and Institutional Financial Services* provides a full range of banking and related services, including electronic banking, large value lease finance, share registration, securities custody, correspondent banking and capital markets services to major UK and multinational companies.

• *Commercial Financial Services* provides financial services to medium-sized businesses in the UK through a network of 89 offices. In addition to a full range of banking services, the Group is a leading provider of factoring, invoice discounting and other asset based financing products together with medium-term debt and venture capital to support expansion, corporate restructuring and changes of ownership.

International Banking provides banking and financial services overseas in three main areas: The Americas, Europe and New Zealand, and also through its offshore banking operations.

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

• *Europe.* International Private Banking covers services to wealthy individuals outside their country of residence. The business is conducted through Switzerland and through 4 other countries overseas. There are additional corporate and private banking operations in Spain and France.

• *New Zealand.* The National Bank of New Zealand is one of the principal banks and provides a full range of banking and financial services through 160 outlets.

• *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 Dubai. 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 49 and 50 and are unchanged from those applied in 1996.

The presentation of dealing profits has been changed, as described on page 49, to give an improved analysis of results. There is no impact on total income, costs, profit before tax or shareholders' funds. 1996 figures have been restated to reflect the new presentation.

Following the mergers of Lloyds Bank and Cheltenham & Gloucester and of Lloyds Bank and TSB Group in 1995 and the acquisition of the minority shareholdings in Lloyds Abbey Life in 1996, the businesses of Lloyds TSB have been grouped into five main businesses for reporting purposes so as to give greater clarity to the Group's performance in these markets:

- Retail Banking
- Mortgages
- Insurance
- Wholesale Markets
- International Banking

Details of the individual businesses making up each grouping are given on the following pages, where the performance of the main businesses is reviewed, and 1996 figures have been restated on a comparable basis.

Summary of group results

Group profit before tax rose by 26 per cent to £3,162 million from £2,505 million in 1996. This includes a net profit before tax of £154 million on the disposal of businesses which no longer fit our strategy (1996: net loss £35 million). Profit attributable to shareholders grew by 48 per cent to £2,335 million, helped by a reduction in minority interests following the acquisition of the minority shareholdings (38 per cent) in Lloyds Abbey Life at the end of 1996 and a lower effective rate of tax. Earnings per share rose by 40 per cent to 43.7p, the post-tax return on equity increased to 40.8 per cent from 32.9 per cent and the post-tax return on assets rose to 1.74 per cent from 1.28 per cent. Economic profit increased by 61 per cent to £1,762 million from £1,096 million in 1996, based on a cost of equity of 10 per cent.

Despite charges against income of £100 million for additional provisions for possible redress to purchasers of pension policies and a write-down of finance leases of £58 million, total income rose by 7 per cent. Net interest income grew by 9 per cent and other income increased by 4 per cent. Although pressure on interest margins on some UK lending products is evident and this trend is likely to continue, the volume and value of interest-free funds have increased. Helped also by a change in the mix of assets, the net interest margin improved by 34 basis points to 3.63 per cent. Continued tight cost control and the capture of synergy benefits from the merger of Lloyds Bank and TSB Group and the integration of Lloyds Abbey Life led to a 5 per cent, or £178 million, reduction in operating expenses. The cost:income ratio improved significantly to 50.4 per cent from 57.0 per cent, further strengthening the Group's competitive position.

Credit quality continued to improve in 1997. Non-performing loans fell to £1,957 million, or 2.1 per cent of lending, from £2,511 million, or 2.8 per cent of lending, in 1996. The domestic charge for bad and doubtful debts dropped to £340 million from £358 million and the charge as a percentage of average lending improved to 0.43 per cent from 0.48 per cent, reflecting the lower charge and growth

Summary of group results (continued)

in the higher quality mortgage portfolio. However, as a result of the expected higher provisions overseas, following the acquisition of Losango Consumer Finance in Brazil, the total charge for bad and doubtful debts rose to £421 million from £327 million. At the end of the year provisions for bad debts totalled £2,493 million, representing over 100 per cent of non-performing lending. We continue to benefit from the prudent management of our Emerging Markets Debt (EMD) portfolio. Based on secondary market prices at the end of 1997, the surplus of market value over net book value of the total EMD portfolio was over £900 million (1996: £900 million).

Profit before tax from ongoing businesses, excluding special items, increased by 16 per cent to £2,893 million. Profit attributable to shareholders rose by 33 per cent, helped by a reduction in minority interests and a lower effective rate of tax, and earnings per share were up 26 per cent. Post-tax return on equity was 36.8 per cent. As total income grew by 8 per cent and operating expenses were reduced by 3 per cent, the trading surplus was increased by 22 per cent and the cost:income ratio improved to 50.7 per cent from 56.2 per cent. Both income and operating expenses include 9 months' results for Losango Consumer Finance. Underlying operating expenses from ongoing businesses (excluding acquisitions and non-merger related disposals) were reduced by 4 per cent. Provisions for bad and doubtful debts increased as expected, reflecting the inclusion for the first time of provisions for the wider margin consumer finance business in Brazil, which previously were included in associated undertakings. In the second half of the year profit before tax from ongoing businesses was up by 11 per cent on the first half.

Ongoing businesses	**1997 £m**	1996 £m
Net interest income	**4,153**	3,730
Other income	**3,100**	2,988
Total income	**7,253**	6,718
Operating expenses	**3,675**	3,776
Trading surplus	**3,578**	2,942
General insurance claims	**145**	120
Provisions for bad and doubtful debts	**560**	413
Amounts provided against fixed asset investments	**3**	5
Operating profit	**2,870**	2,404
Income from associated undertakings	**23**	84
Profit before tax from ongoing businesses	**2,893**	2,488
Disposal of investments	**–**	42
Profit (loss) on sale of businesses	**154**	(77)
Emerging Markets Debt	**173**	127
Restructuring provision	**–**	(75)
Write-down of finance leases	**(58)**	–
Group profit before tax	**3,162**	2,505
Profit attributable to shareholders from ongoing businesses	**2,107**	1,580
Earnings per share from ongoing businesses	**39.4p**	31.3p

Profit before tax by main businesses

	1997 £m	1996 £m
Retail Banking	**832**	717
Mortgages	**693**	522
Insurance	**529**	514
Retail Financial Services	**2,054**	1,753
Wholesale Markets	**653**	559
International Banking	**425**	375
Central group items	**88**	(182)
Write-down of finance leases	**(58)**	-
Profit before tax	**3,162**	2,505
Profit attributable to shareholders	**2,335**	1,575

Retail Financial Services

Total profit before tax from Retail Financial Services, encompassing the Retail Banking, Mortgages and Insurance businesses, increased by £301 million, or 17 per cent, to £2,054 million from £1,753 million in 1996. Profit attributable to shareholders from Retail Financial Services increased by 38 per cent, helped by a reduction in minority interests and a lower effective rate of tax.

Retail Banking and Mortgages

Total profit before tax from Retail Banking and Mortgages rose by £286 million, or 23 per cent, to £1,525 million. Total income increased by 6 per cent and costs were reduced by 3 per cent, giving a 19 per cent increase in the trading surplus, and the cost:income ratio improved to 54.4 per cent from 59.4 per cent. Bad debt provisions were £18 million, or 6 per cent, higher than a year ago at £340 million, reflecting volume growth.

	1997 £m	1996 £m
Net interest income	**2,884**	2,719
Other income	**1,202**	1,124
Total income	**4,086**	3,843
Operating expenses	**2,221**	2,282
Trading surplus	**1,865**	1,561
Provisions for bad and doubtful debts	**340**	322
Profit before tax	**1,525**	1,239
Profit attributable to shareholders	**1,085**	811
Profit before tax:		
Retail Banking	**832**	717
Mortgages	**693**	522
	1,525	1,239
Cost:income ratio	**54.4%**	59.4%
Total assets (year-end)	**£64.1bn**	£65.1bn
Total risk-weighted assets (year-end)	**£42.9bn**	£42.8bn

Retail Banking

(the UK retail businesses of Lloyds Bank and TSB, providing banking and financial services to personal and small business customers, Lloyds UDT, UK private banking and retail stockbroking, Hill Samuel Asset Management and estate agencies)

Pre-tax profit from Retail Banking rose by £115 million, or 16 per cent, to £832 million, reflecting increased volumes and tight cost control.

There was a small increase in provisions, reflecting volume growth. During the past year we have tightened our lending criteria to maintain the quality of the portfolio. Personal loans and credit card lending grew by 13 per cent, and there was good growth in current account balances, savings and investments.

Business Banking provides services to over 500,000 small business customers through the branch networks, telephone banking and, increasingly, computer links. Helped by favourable economic conditions, new business recruitment and market share have continued to grow. Customer satisfaction has increased and profitability has improved, with modest growth in lending and strong growth in deposits. Bad debts have also improved. As part of a continued drive to improve customer service, TSB Business Banking managers have been brought closer to their customers through the establishment of over 100 TSB business centres.

The businesses of Lloyds Bowmaker and UDT have been combined to form Lloyds UDT. Trading conditions remain highly competitive, with continuing pressure on margins, nevertheless, new business volumes grew by 6 per cent. Work on consolidating the new Finance House group is proceeding satisfactorily. The assets of Business Technology Finance were sold in September and Endeavour Personal Finance Limited was sold in December. The benefits of rationalisation will be achieved mainly in 1998 and 1999.

Private Banking had a successful year with profits well ahead of 1996. Income growth was strong as a result of favourable equity markets earlier in the year, and new client funds of over £1 billion were taken under discretionary management. There were also further efficiency gains. Total funds managed and administered now stand at £9.6 billion.

Lloyds Bank Stockbrokers, one of the largest retail stockbrokers in the UK through its Sharedeal Direct telephone service, saw record volumes and income, helped by the strong equity markets and the demutualisation of former building societies.

The Group's estate agency businesses have been combined under Black Horse Agencies. A review of the branch network resulted in the closure of under-performing branches, together with the disposal, in October, of the commercial parts of the business in the Northern Home Counties and Midlands to a management team. However, as a result of improved trading conditions, operating profits before discontinued business costs were £7 million. Total sales were 56,000 units and total income increased by 7 per cent to £116 million.

Mortgages

(Cheltenham & Gloucester, and Mortgage Express until the sale in May 1997)

	1997	1996
Gross new mortgage lending	**£7.8bn**	£8.3bn
Market share of gross new mortgage lending	**10.1%**	11.7%
Net new mortgage lending	**£2.8bn**	£3.2bn
Market share of net new mortgage lending	**11.4%**	17.2%
Mortgages outstanding (year-end)	**£41.8bn**	£39.0bn*
Market share of mortgages outstanding	**9.6%**	9.5%*

* *Excluding Mortgage Express assets of £1.6 billion.*

Pre-tax profit from Mortgages grew by £171 million, or 33 per cent, to £693 million.

Although there has been some improvement in the housing market and in property prices in 1997, this has varied throughout the country, with the greatest activity in London and the South East. Nevertheless, a greater proportion of new business has come from first-time buyers and people moving house and remortgage business has declined. Competition has remained strong, with some competitors adopting aggressive pricing policies and generous incentives to acquire new business. Against this background C&G has focused on maintaining profitability and credit quality and delivering first class service.

As a result gross new mortgage lending and net new lending were slightly lower than a year ago. However, our estimated market share of net new lending was 11.4 per cent, compared with a market share of total mortgage assets of 9.6 per cent. Total mortgages outstanding rose by 7 per cent to £41.8 billion at the end of 1997 from £39.0 billion at the end of 1996. C&G mortgages were sold through C&G and Lloyds Bank branches and by C&G Mortgage Direct throughout 1997 and, on a phased basis, also through TSB branches in England and Wales from September.

The net interest margin has improved in 1997. With several increases in bank base rates, and consequently variable mortgage rates, the proportion of lending at fixed rates has also increased during the year. Costs continue to be kept under tight control and bad debt provisions remain at a low level, reflecting an improving arrears position, good recoveries and benefits from an increase in house prices.

Lloyds TSB Group is the third largest residential mortgage lender in the UK, with C&G being one of the leading mortgage brands. The Group intends to build upon its strengths as a low cost producer with an extensive distribution network, whilst seeking to ensure that an acceptable balance is maintained between profitability and market share.

Insurance

(the life, pensions and unit trust businesses of Abbey Life, Black Horse Financial Services, TSB Life and Pensions and Hill Samuel Life Assurance; general insurance broking through Lloyds Bank Insurance Services; general insurance underwriting through TSB General Insurance and Ambassador Insurance)

	1997 £m	1996 £m
Life and pensions (including unit trusts) – underlying profit	**418**	333
General insurance	**224**	170
	642	503
Pension provisions and one-off tax items	**(113)**	11
Profit before tax	**529**	514
Profit attributable to shareholders	**363**	240

Profit before tax from the Insurance businesses rose by £139 million, or 28 per cent, to £642 million, before a charge of £113 million for pension provisions and one-off tax items. Helped by a reduction in minority interests, profit attributable to shareholders increased by 51 per cent.

Life and pensions (including unit trusts)

In our Bancassurance businesses sales of life, pensions and unit trusts rose by 14 per cent. Over £1.25 billion of sales of savings products were made to customers of Lloyds Bank and TSB in bonds and unit trusts. Regular contribution PEPs rose by 38 per cent to £70 million. Strong growth was also achieved in mortgage related products.

In Abbey Life weighted sales were down by 18 per cent, as record sales through brokers of the high income bond in 1996 were not repeated. Sales were also affected by an extensive retraining of the salesforce in connection with the introduction of a new point-of-sale system and to qualify the salesforce for financial planning certification.

	1997 £m	1996 £m
Profit before tax:		
New business	108	121
Existing business	179	244
Investment earnings	64	45
Life distribution costs	(74)	(84)
	277	326
Unit trusts	70	49
Unit trust distribution costs	(42)	(31)
	305	344
Profit attributable to shareholders	209	161
New business premium income and unit trust sales:		
Regular premiums:		
Life	67	70
Pensions	76	73
Other	5	5
Total regular premiums	148	148
Single premiums:		
Life	504	785
Pensions	343	295
Total single premiums	847	1,080
External unit trust sales:		
Regular payments	73	54
Single amounts	933	774
Total external unit trust sales	1,006	828
Weighted sales (regular + 1/10 single)	399	387
Life funds under management	20,046	18,139

Life and pensions (including unit trusts) (continued)

Underlying profit from life and pensions increased by £85 million, or 26 per cent, to £418 million, before pension provisions and one-off tax items. Provisions for possible redress for purchasers of pension policies were increased by £100 million, raising the total group provision made for this purpose to £300 million. The increase reflects the experience as the review progresses, the tightening of the timetable for completion and the effect of the withdrawal of dividend tax credits. The change to the treatment of tax credits also reduced the value of the pension element of the long-term assurance business, resulting in a one-off charge of £13 million (1996 included a provision of £39 million offset by one-off tax benefits).

The merger of Black Horse Financial Services and TSB Life and Pensions is well advanced. The integration of the administration offices of Bancassurance operations will result in an improved service to customers and future cost savings.

General Insurance

Pre-tax profit from general insurance operations, comprising underwriting and broking, rose by £54 million, or 32 per cent, to £224 million.

During the year the general insurance businesses of Lloyds and TSB were merged into one business, which will continue to undertake both underwriting and broking. We shall underwrite where risks, rewards and volatility of earnings are acceptable and broke where there is a higher risk and in specialist markets.

In 1997 income from loan related insurance increased by 11 per cent, reflecting increased penetration and higher loan values. Loss ratios for the portion of this business underwritten internally improved, reflecting improved economic conditions.

Sales of regular premium household and health insurance policies by branches increased by 38 per cent and direct sales made by our telephone sales operation increased by 40 per cent. The overall increase in sales, together with renewal business, produced a 23 per cent increase in commission income from broking and a 9 per cent increase in earned premium income from underwriting. Investment income increased by 66 per cent to £54 million, reflecting increased interest rates together with improvement in the equity market.

The underlying loss ratios for all products improved, with the overall ratio improving to 42 per cent in 1997. To reduce risk exposure during a period of change, we have increased our reinsurance programme and have taken the opportunity of providing an additional £25 million to cover larger events, increasing the total loss ratio to 51 per cent.

Wholesale Markets

(banking, treasury, large value lease finance, share registration, securities custody, venture capital, factoring and invoice discounting, and other related services for major UK and multinational companies, banks and institutions, and medium-sized UK businesses)

	1997 £m	1996 £m
Net interest income	**584**	598
Other income	**590**	568
Total income	**1,174**	1,166
Operating expenses	**521**	571
Trading surplus	**653**	595
Provisions for bad and doubtful debts	**–**	36
Profit before tax and write-down of finance leases	**653**	559
Write-down of finance leases	**58**	–
Profit attributable to shareholders	**472**	388
Cost:income ratio	**44.4%**	49.0%
Total assets (year-end)	**£53.9bn**	£45.9bn
Total risk-weighted assets (year-end)	**£25.3bn**	£24.5bn

Wholesale Markets pre-tax profit increased by £94 million, or 17 per cent, to £653 million. This excludes the write-down of finance leases of £58 million arising from a reduction in the rate of corporation tax, which affects the leasing industry as a whole.

Total assets rose by 17 per cent from a year ago, reflecting growth in low risk treasury assets, but as a result of a change in the mix of assets risk-weighted assets grew by only 3 per cent. Income increased by 1 per cent and operating expenses were reduced by 9 per cent, so the trading surplus increased by 10 per cent. The net provisions charge was nil, helped by further recoveries and releases.

Our Commercial Financial Services businesses, serving the commercial middle market, made excellent progress. Commercial Banking increased revenues and reduced provisions to achieve a record profit. Our venture capital business, Lloyds Development Capital, had a good year, realising higher capital gains, as a result of the successful flotation or sale of investments made in recent years. The factoring and invoice discounting businesses also showed continued profitable growth despite somewhat reduced margins.

Although interest rates have edged upwards during 1997, income from Treasury sterling money market operations has held up well compared with 1996. However, income from currency money market operations has fallen from the high levels in 1996, reflecting less favourable market conditions. As the derivatives markets become more commoditised, spreads have tightened, which has reduced income in the major currencies. The Group's activity in the derivatives markets remains focused on straight cash based products.

Our Corporate and Institutional Financial Services businesses, serving the larger corporate market, achieved a good increase in their contribution in 1997. Despite strong competition for good quality lending and money transmission business, Corporate and Institutional Banking's continuing focus on profitability led to improved interest margins, costs were lower than a year ago and there was a small release of provisions. Hill Samuel Bank's corporate portfolio was successfully integrated and savings have been achieved. Lloyds Leasing, one of the biggest 'large value' leasing companies in the UK, wrote new business of £800 million, covering films, power stations, shopping centres, plant and equipment, and trams. Lloyds Bank Registrars maintained its market leadership and achieved record profits, with exceptional activity from demutualisations and demergers. Lloyds Bank Securities Services continues to invest in new systems and increased its income, with higher volumes and transaction values.

International Banking

(banking and financial services overseas, principally in Latin America, Europe and New Zealand, International Private Banking, Offshore Banking and Emerging Markets Debt)

	1997 £m	1996 £m
Net interest income	**660**	431
Other income	**412**	392
Total income	**1,072**	823
Operating expenses	**575**	549
Trading surplus	**497**	274
Provisions for bad and doubtful debts – charge (release)	**81**	(31)
Income from associated undertakings	**9**	70
Profit before tax	**425**	375
Profit attributable to shareholders	**295**	260
Cost:income ratio	**53.6%**	66.7%
Total assets (year-end)	**£17.3bn**	£15.6bn
Total risk-weighted assets (year-end)	**£11.5bn**	£13.2bn

International Banking pre-tax profit rose by £50 million, or 13 per cent, to £425 million. Excluding Emerging Markets Debt, pre-tax profit from international operations was £252 million, compared with £248 million in 1996.

Profits were up in The National Bank of New Zealand, International Private Banking and Offshore Banking, but down in Latin America owing to weaker results in Brazil. Schröder Münchmeyer Hengst, the German private bank, was sold to Union Bank of Switzerland in September.

In April 1997 we obtained 100 per cent control of Losango Consumer Finance in Brazil and its results are fully consolidated in the profit and loss account as a subsidiary from that date. The results reflect the wider margins and provisioning levels associated with this consumer finance business, and have a significant impact on the income and provisions of International Banking and to a lesser extent on operating expenses. After a loss of £11 million in the first half of the year, Losango made a profit of £12 million in the second half and we expect to see a lower level of provisions and improved results in 1998.

In the second half of 1997 we increased our interest in Banco Anglo Colombiano from 49 per cent to 61 per cent, and its results are included as a subsidiary from 1 October 1997, having previously been accounted for as an associate. The effect of this change on International Banking's figures was small.

Emerging Markets Debt contributed £173 million, which included a release of provisions of £139 million, mainly as a result of asset sales. This compared with a contribution of £127 million in 1996, which included a release of provisions of £86 million. At the end of 1997 the Group's provisionable exposure to Emerging Market economies which is included in loans and advances was £1,391 million (1996: £1,634 million) against which provisions of £859 million (1996: £959 million) were held, giving cover of 62 per cent (1996: 59 per cent). Based on secondary market prices, the surplus of market value over net book value of the total Emerging Markets Debt portfolio (including advances, unapplied interest and collateralised bonds held as investments) was more than £900 million (1996: £900 million).

Central group items

(central costs and other unallocated items)

	1997 £m	1996 £m
Sale of businesses	154	(77)
Sale of investment in Macquarie Bank	–	42
Central costs and other unallocated items	(66)	(72)
Restructuring provision	–	(75)
Net surplus (deficit)	88	(182)
Net surplus (deficit) attributable to shareholders	120	(124)

There was a net surplus on central group items of £88 million, after taking account of the profit of £154 million on the sale of businesses.

Net interest income

Group net interest income increased by £345 million, or 9 per cent, to £4,114 million, despite the cost of funding the payment of cash and a special dividend to the minority shareholders in Lloyds Abbey Life at the end of 1996 and the write-down of finance leases of £58 million. Average interest-earning assets were virtually unchanged at £114.9 billion. Growth in mortgages, personal loans and credit card lending in the UK and the addition of the £1 billion consumer finance portfolio in Brazil were offset by the sale of a number of businesses and the effect of exchange rate movements. The net interest margin improved by 34 basis points to 3.63 per cent, partly as a result of the higher margins earned in Brazil as lending is shifted from lower margin wholesale lending to wider margin consumer finance, but also reflecting a higher spread on our domestic business and a higher contribution from interest-free liabilities.

	1997	1996*
Group:		
Net interest income £m	4,114	3,769
Average interest-earning assets £m	114,901	114,487
Gross yield on interest-earning assets %	8.87	8.24
Interest spread %	2.91	2.67
Net interest margin %	3.63	3.29
Domestic:		
Net interest income £m	3,519	3,392
Average interest-earning assets £m	97,819	96,616
Gross yield on interest-earning assets %	8.10	7.75
Interest spread %	2.99	2.94
Net interest margin %	3.66	3.51
International:		
Net interest income £m	595	377
Average interest-earning assets £m	17,082	17,871
Gross yield on interest-earning assets %	13.23	10.90
Interest spread %	2.69	1.43
Net interest margin %	3.48	2.11

* *Restated as described on page 49.*

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 group and domestic interest spread and net interest margin exclude the £58 million write-down of finance leases in 1997

e) 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

For details of payments made under cash gift and discount mortgage schemes, see page 57 note 30.

Net interest income (continued)

Domestic net interest income increased by £127 million, or 4 per cent, to £3,519 million. Average interest-earning assets rose by 1 per cent to £97.8 billion. Growth in mortgages, personal loans and credit card lending and in low risk treasury assets was partly offset by the sale of Mortgage Express. The net interest margin improved by 15 basis points to 3.66 per cent, reflecting a wider spread and an improved contribution from interest-free liabilities as a result of higher volumes and higher interest rates.

Net interest income from international operations increased by £218 million, or 58 per cent, to £595 million, representing 14 per cent of total group net interest income. Average interest-earning assets were reduced by 4 per cent; an increase on the addition of the consumer finance portfolio in Brazil was offset by a reduction in treasury assets in New Zealand, the sale of Schröder Münchmeyer Hengst in Germany and the effect of exchange rate movements. The net interest margin improved significantly to 3.48 per cent, reflecting the wider margins earned on the consumer finance business in Brazil.

Other income

Other income increased by £123 million, or 4 per cent, to £3,116 million, which represented 43 per cent of total income.

Fees and commissions receivable increased by 8 per cent, reflecting increased business volumes, in particular from asset management services and share registration, and there was strong growth in income from general insurance broking. Fees and commissions payable increased, as a result of higher dealer commissions paid for the introduction of new business and higher interchange fees for card services.

Dealing profits held up well, but income from long-term assurance business was down, as a result of the charge of £113 million for pension provisions and one-off tax items. Higher volumes produced an increase in general insurance premium income from underwriting and the improvement in other operating income included higher gains on the realisation of venture capital investments.

	1997 £m	1996* £m
Dividend income from equity shares	10	10
Fees and commissions receivable:		
UK current account fees	552	536
Other UK fees and commissions	973	896
Insurance broking	237	192
Card services	227	207
Estate agency fees	116	108
International fees and commissions	277	265
	2,382	2,204
Fees and commissions payable	(317)	(269)
Dealing profits (before expenses):		
Foreign exchange trading income	105	110
Securities and other gains	118	107
	223	217
Income from long-term assurance business	328	403
General insurance premium income	284	261
Other operating income	206	167
Total other income	3,116	2,993

* *Restated as described on page 49.*

Operating expenses

Total operating expenses were reduced by £178 million, or 5 per cent, despite additional expenditure of £41 million in preparation for the year 2000 and the single European currency and costs relating to the consumer finance business in Brazil, which were previously included in a net profit figure under associates. The bulk of the reduction was achieved through lower staff costs, largely as a result of a fall in the number of employees of over 8,600 since the merger at the end of 1995 (including 1,340 from the sale of businesses not core to the merged company). It also included a net pensions credit of £90 million; this follows interim actuarial valuations of the Lloyds Bank and TSB Group pension schemes as at 30 June 1997 and takes account of the estimated impact of the withdrawal of dividend tax credits. The cost:income ratio improved significantly to 50.4 per cent from 57.0 per cent, further strengthening the Group's competitive position and economic profit.

	1997 £m	1996 £m
Administrative expenses		
Staff:		
Salaries and profit sharing	1,579	1,717
National insurance	138	135
Pensions	(90)	(58)
Restructuring	35	47
Other staff costs	185	184
	1,847	2,025
Premises and equipment:		
Rent and rates	281	260
Hire of equipment	45	44
Repairs and maintenance	95	98
Other	125	101
	546	503
Other expenses:		
Communications and external data processing	383	369
Advertising and promotion	151	130
Professional fees	119	103
Other	383	395
	1,036	997
Administrative expenses	3,429	3,525
Restructuring provision	–	75
Total administrative expenses	3,429	3,600
Depreciation	247	254
Total operating expenses	3,676	3,854
Cost:income ratio (excluding write-down of finance leases)	50.4%	57.0%

We remain confident of meeting our stated aim of achieving cost reductions of at least £400 million per annum by 1999 from the merger of Lloyds Bank and TSB Group and the integration of Lloyds Abbey Life. Since the merger at the end of 1995, excluding the acquisitions of Losango Consumer Finance and Banco Anglo Colombiano and the sale of Schröder Münchmeyer Hengst, which were not related to the merger, underlying operating expenses have been reduced by some £220 million, or 6 per cent.

Operating expenses (continued)

	1997 £m	1996 £m	1995 £m
Total operating expenses	**3,676**	3,854	4,275*
Restructuring provision	**–**	(75)	(425)
	3,676	3,779	3,850
Acquisitions:			
Losango Consumer Finance	**(69)**	–	–
Banco Anglo Colombiano	**(6)**	–	–
Non-merger related disposals:			
Schröder Münchmeyer Hengst	**(30)**	(56)	(62)
Underlying operating expenses	**3,571**	3,723	3,788

** Includes a full year's operating expenses for C&G*

During 1997 £198 million of restructuring costs, arising from the merger of Lloyds Bank and TSB Group and the integration of Lloyds Abbey Life, were charged against the restructuring provisions totalling £500 million made in 1995 and 1996, bringing the total charged to date to £302 million.

Number of employees (full-time equivalent)

After adjusting for the change in status of Losango Consumer Finance and Banco Anglo Colombiano, there was a net reduction of 4,426 in the total number of employees during 1997. There were increases in the telephone banking, retail stockbroking, card services and share registration businesses, but these were more than offset by reductions in other parts of the Group from the sale of businesses (1,274), from rationalisation arising from the merger of Lloyds Bank and TSB Group and the integration of Lloyds Abbey Life, and from continuing investment in technology and productivity improvements. Further reductions are expected in 1998.

	31 December 1997	31 December 1996
Retail Banking*	**52,738**	56,089
Mortgages	**3,715**	4,020
Insurance	**6,375**	6,385
Retail Financial Services	**62,828**	66,494
Wholesale Markets	**6,162**	6,055
International Banking†	**12,669**	13,458
Other	**921**	999
Total number of employees (full-time equivalent)	**82,580**	87,006

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

† 1996 figures have been restated to include Losango Consumer Finance and Banco Anglo Colombiano as subsidiaries, having previously been accounted for as associates.

Charge for bad and doubtful debts

Non-performing loans fell to £1,957 million, or 2.1 per cent of lending, from £2,511 million, or 2.8 per cent of lending, in 1996. However, the total charge for bad and doubtful debts rose to £421 million from £327 million. New and additional provisions increased, reflecting the expected higher provisions in Brazil, but releases and recoveries were also higher than a year ago.

Charge for bad and doubtful debts (continued)

Credit quality in the UK continued to improve and the domestic charge dropped to £340 million from £358 million. Domestic lending represents 87 per cent of total customer lending, and the domestic charge as a percentage of average lending improved to 0.43 per cent from 0.48 per cent, reflecting the lower charge and growth in the higher quality mortgage portfolio.

Provisions overseas were £81 million. The charge for credit risks was £220 million, largely relating to provisions for the consumer finance business in Brazil, which previously were included in associated undertakings. This was partly offset by a release of provisions of £139 million for Emerging Markets Debt, mainly as a result of asset sales.

	1997 £m	1996 £m
Domestic:		
Retail Banking	**324**	302
Mortgages	**16**	20
Wholesale Markets	**–**	36
Total domestic	**340**	358
International Banking	**81**	(31)
Total charge	**421**	327
Specific provisions	**418**	357
General provisions	**3**	(30)
Total charge	**421**	327
Charge as % of average lending:	**%**	%
Domestic	**0.43**	0.48
International	**0.67**	(0.26)
Total charge	**0.46**	0.38

The Group's exposure to the 5 troubled Asian economies: Indonesia, Malaysia, Philippines, South Korea and Thailand, is less than £600 million (0.4 per cent of total group assets), of which South Korea represents £330 million, and relates to interbank lending and Brady bonds; there is no commercial debt. All the debt is performing and the need for provisions is not expected to arise. However, should any provisioning become necessary, the Group is already well provided on its Emerging Markets Debt portfolio.

Total provisions for bad and doubtful debts

At the end of 1997 provisions for bad and doubtful debts totalled £2,493 million. This represented 2.7 per cent of total lending and over 100 per cent of non-performing loans. Movements in provisions during the year included a one-off transfer of £110 million from general to specific provisions, reflecting a reallocation of provisions arising from the harmonisation of provisioning methodologies in Lloyds Bank and TSB. This transfer is a balance sheet movement and does not affect profit before tax. However, profit after tax benefits from tax relief on the specific provisions. *(Movements in provisions during the year are shown on page 53 in note 17.)*

Total provisions for bad and doubtful debts (continued)

Total provisions for bad and doubtful debts as % of lending (excluding unapplied interest)	**31 December 1997 £m**		31 December 1996 £m	
Specific:				
Domestic	**882**	**(1.1%)**	964	(1.3%)
International	**1,241**	**(10.1%)**	1,102	(9.1%)
	2,123	**(2.3%)**	2,066	(2.3%)
General	**370**	**(0.4%)**	480	(0.5%)
Total	**2,493**	**(2.7%)**	2,546	(2.8%)

Tax

The tax charge for 1997 of £813 million (1996: £786 million) was 26 per cent of profit before tax (1996: 31 per cent), compared with an average UK corporation tax rate for 1997 of 31.5 per cent (1996: 33 per cent). The lower rate of tax charged in 1997 reflects a combination of factors including: a reduction in the corporation tax rate from 33 per cent to 31 per cent from 1 April 1997, tax relief on the transfer from general to specific provisions described on page 26, the absence of a tax charge on the profit on the sale of certain businesses and a reduction in the deferred tax liability associated with the one-off write-down of finance leases as a result of the reduction in the corporation tax rate. *(For further details of the tax charge see page 52, note 10.)*

The rate of tax is influenced by the geographic and business mix of profits. In the absence of special factors, it is not expected to vary significantly from 31 per cent.

Investment for the future

In 1997, we invested £264 million in premises and equipment, compared with £242 million in 1996. Capital expenditure over the past 5 years has totalled £1,307 million. This investment has been mainly in support of UK operations, in the retail businesses and in new technology to enhance future profitability. It has been wholly financed by a combination of internally generated funds and disposals. At the end of 1997, there were further capital expenditure commitments of £6 million in respect of premises and equipment.

In addition, we incur significant costs each year on improving systems and on staff training programmes to enhance customer service and efficiency, as well as on the continuing refurbishment and maintenance of premises; these costs are charged to the profit and loss account.

Shareholder returns

Dividends of £925 million (an increase of 30 per cent per share) are covered 2.5 times by earnings (2.3 times for ongoing businesses). Profit of £1,410 million will be retained in the business. Total shareholders' funds grew by £1,180 million, or 23 per cent, to £6,254 million (115p per share) from £5,074 million (94p per share) at the end of 1996.

In 1997 the Company's share price increased by 83 per cent to 789p per share from 430p at the end of 1996. This compared with an increase of 20 per cent in the FTSE All Share Index. The highest price during the year was 850.5p, the lowest 428p. At the end of 1997 the Company had a market capitalisation of £42.6 billion. Based on the year-end share price the price:earnings ratio was 18.1 (1996: 13.8).

Taking the increase in the share price and dividends together, the total return to shareholders in 1997 was 87 per cent, on top of a 35 per cent return in 1996.

Shareholder returns (continued)

We continue to use economic profit as a measurement of performance, which is the best way to understand the true value being created for shareholders. Economic profit represents the profit attributable to shareholders less a charge for the equity invested in the business. In 1997 economic profit increased by 61 per cent to £1,762 million from £1,096 million in 1996. Our calculation of economic profit uses average equity for the year and is now based on a cost of equity of 10 per cent, compared with the 12 per cent used in 1996, as a result of a reduction in the long-term risk free rate. 1996 figures have been restated.

Capital ratios

The international standard for measuring capital adequacy is the risk asset ratio, which relates capital to balance sheet assets and off-balance sheet exposures weighted according to broad categories of risk. In 1997 total capital increased by £840 million to £8,625 million. Tier 1 capital rose by £1,031 million; an increase from retained profits was partly offset by a goodwill write-off of £164 million and a write-down of premises. Tier 2 capital increased by £120 million, reflecting the issue of £500 million loan capital and the effect of exchange rate movements less repayments and amortisation of previous issues of loan capital and the reduction in the general provision. Supervisory deductions increased by £311 million, resulting from growth in the insurance businesses. Risk-weighted assets were reduced by £0.8 billion, or 1 per cent, to £79.9 billion, reflecting the sale of businesses. At the end of 1997 the risk asset ratios improved to 10.8 per cent for total capital and to 7.9 per cent for tier 1 capital.

	31 December 1997 £m	31 December 1996 £m
Capital: tier 1	**6,294**	5,263
: tier 2	**4,376**	4,256
	10,670	9,519
Supervisory deductions	**(2,045)**	(1,734)
Total capital	**8,625**	7,785
	£bn	£bn
Risk-weighted assets:		
Retail Banking	**21.7**	21.4
Mortgages	**21.2**	21.4
Insurance	**0.1**	0.1
Retail Financial Services	**43.0**	42.9
Wholesale Markets	**25.3**	24.5
International Banking	**11.5**	13.2
Central group items	**0.1**	0.1
Total risk-weighted assets	**79.9**	80.7
Risk asset ratios: total capital	**10.8%**	9.6%
: tier 1	**7.9%**	6.5%

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

Group risk management

The Director of Group Risk Management is responsible for ensuring compliance with the policy established by the Lloyds TSB Group board on the whole range of financial and other risks it faces in the course of its business. Policy is implemented through a number of Group risk departments responsible *inter alia* for the following:

Liquidity risk

The Group complies with the Bank of England's Sterling Stock Liquidity policy introduced in 1996. Although this policy is aimed only at UK based sterling business, internal Lloyds TSB Group liquidity management operates in a similar fashion for all activities and trading centres across the world, in all currencies. Trading centres in each country are required to maintain sufficient liquidity to meet their own business needs, and compliance is monitored by way of regular liquidity returns to head office.

Liquidity policy is aimed at ensuring that the Group and each component business unit can meet its cash financial obligations as and when they fall due. Sufficient volumes of high quality liquid instruments are held to meet wholesale liability maturities and undrawn facilities, and to satisfy customer demands for deposit withdrawal.

The sources and maturities of assets and liabilities are closely monitored and diversified to avoid any undue concentration of funding requirements at any one time or from any one source. A substantial proportion of deposits is made up of retail current and savings accounts which, although repayable on demand or at short notice, have traditionally formed a stable deposit base.

In the wholesale markets, the Group has a significant involvement in the London money market and in other financial centres where it operates. This involvement and the strength of the Group's earnings and balance sheet are important factors in assuring the continued availability of wholesale deposits at competitive market rates.

Credit risk

Credit risk arises from extending credit in all forms, where there is a possibility that a counterparty may default, and from trading activities, which expose the Group to both settlement and market replacement risk. The Group is committed to a strong credit culture that recognises the need to ensure that risk assets are of high quality.

The role of Group Credit, within Group Risk Management, is to formulate high-level credit policies, set standards, monitor the overall portfolios and provide an independent review of all major counterparty and sector risks. The Group's executive committee and board receive regular reports on all significant credit exposures.

Day-to-day credit management is the primary responsibility of business units which, in turn, are required to have in place a detailed lending policy which provides lending officers with defined responsibilities as well as a disciplined and focused benchmark for sound credit decision making. Credit authorisations are based on a discretionary limit structure tailored to meet each business unit's specific requirements.

Cross-border risk and bank risk are measured by way of in-house proprietary rating systems and approved centrally. Sub-limits are set according to maturity and type of business.

Market risk

In the context of the Lloyds TSB Group's business, market risk primarily means exposure to interest and exchange rate risk. The Group has little or no exposure to equity or commodity risks. The Group's management of its exposure to market risk recognises a fundamental distinction between the core (retail) balance sheet and the Group's money market and trading (wholesale) activities.

The exposure of the core balance sheet to interest rate risk is controlled by Group Balance Sheet Management (GBSM) using simulation techniques, under the oversight of the Group asset and liability committee. Foreign currency assets are matched with deposits in the same currency wherever appropriate. The policy is to be broadly neutral in relation to interest rate movements, and the main objective is to limit the adverse effect of defined rate movements on the consistency of the Group's net interest income. Transactions are undertaken by GBSM through Group Treasury as appropriate to achieve this objective.

The Group's money market and trading activities, which involve dealing in both cash and derivatives markets, are carried out predominantly by Group Treasury in London, and by trading centres in each country in which the Group operates. The exposures to interest rate and exchange rate risk to which these activities give rise are strictly controlled and closely monitored within appropriate prudential limits at local level and centrally by Group Market Risk (GMR). Traditional controls on the size of positions are supplemented by a range of value at risk techniques. In consultation with GMR, different methodologies have been developed at local level to meet local business needs. At Group level, global positions are incorporated into a central value at risk model to take into account natural offsets between the positions at different trading centres. In addition stress tests are carried out to simulate extreme conditions.

Estimates of value at risk on a given portfolio of positions vary considerably depending on the parameters used. In order to avoid undue reliance on a single measure, the Group uses value at risk estimates based on both 95 per cent and 99 per cent confidence intervals, assuming holding periods of 1 and 10 days respectively, with observation periods varying from 30 days to 5 years. During 1997 estimated value at risk on the Group's global trading (marked to market) activities, averaged £1.82 million. The maximum value at risk recorded was £2.45 million and the figure at 31 December 1997 was £2.45 million (1996: £2.17 million). These estimates are based on the commonly quoted 95 per cent confidence interval, assuming positions were held overnight and using (for most currencies) observation periods of 3 calendar years preceding the reporting date.

Insurance risk

The Group offers insurance products to its customers and actively reviews the extent to which the associated risk is underwritten internally, within the life and pensions and general insurance businesses, or transferred to external underwriters by insurance broking arrangements.

The Department of Trade and Industry sets down minimum requirements for solvency and reserving for all classes of insurance, which are met or exceeded by the Group's companies. Risk levels retained within the Group are carefully controlled and monitored with close attention being paid to the analysis of underwriting experiences, product design, policy wordings, adequacy of reserves, solvency management and regulatory requirements. Investment strategy determines 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 mitigated by reinsurance arrangements which are broadly spread over different reinsurers. Appropriate reinsurance arrangements also apply within the life and pensions businesses.

Environmental risk

The Group has a dedicated environmental risk unit which provides advice and guidance on environmental issues to business units. During the year, new detailed environmental risk management guidelines were issued across the Group. These are to be backed by a comprehensive training programme for lending officers during 1998. In addition, the Group has carried out a review of internal operations, using independent environmental consultants, and will use this as the foundation for a programme of environmental management initiatives.

Operational risk

Operational risk represents exposure to financial loss or reputational damage inherent in all business activities that might arise from system failures, inadequate internal controls and procedures, human error, deliberate malicious acts including fraud, business interruptions and risk emanating from specific events such as the year 2000 computer problem.

Business units within the Group are responsible for managing all identified risks, which are monitored by Internal Audit within group-wide standards of control. Internal control techniques cover segregation of duties, exception and exposure reporting, business continuity planning, reconciliations and delegation of authority and are based on submission of timely and reliable management information. Where appropriate, risk is transferred to third parties by way of insurance or outsourcing.

An independent assessment of the strength of the operational risk framework is provided to the Group board by Group Risk Management, primarily through the work of internal and external audit processes, supported where necessary by specialist input.

Derivatives

Derivatives are used to meet the financial needs of customers, as part of the Group's trading activities and to reduce its own exposure to fluctuations in interest and exchange rates. The principal derivatives used by the Group are interest rate and exchange rate related contracts.

Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal amount at a specific date in the future. At 31 December 1997 the total notional principal amount of interest rate related contracts outstanding was £825.3 billion (31 December 1996: £752.6 billion) of which £477.6 billion (31 December 1996: £397.1 billion) were interest rate swaps and £240.9 billion (31 December 1996: £236.4 billion) were forward rate agreements.

Exchange rate related contracts include forward foreign exchange contracts, currency swaps and options. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. At 31 December 1997 the total notional principal amount of exchange rate related contracts outstanding was £156.3 billion (31 December 1996: £216.0 billion) of which £138.7 billion (31 December 1996: £201.6 billion) related to futures and forward foreign exchange contracts.

Derivatives (continued)

The volume of notional principal amounts 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. At the end of 1997 the total potential loss, or net replacement cost, on interest rate contracts was £1.5 billion (31 December 1996: £1.8 billion) and on exchange rate contracts was £1.9 billion (31 December 1996: £2.4 billion). To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against exposure. The reduction in the net replacement cost of both interest rate and exchange rate contracts in 1997 reflects lower volatility.

Equity derivatives are also used by the Group as part of its equity based retail product activity, whereby index-linked equity options are purchased to eliminate the Group's exposure to fluctuations in various international stock exchange indices. At 31 December 1997 the total notional principal amount of equity contracts was £1.4 billion (1996: £0.4 billion).

All derivatives activity is subject to the same credit approvals, limits and monitoring procedures used for other credit transactions, all of which are aggregated to measure total counterparty risk. Derivatives exposure to individual counterparties is calculated daily as the sum of mark-to-market values and conservative add-ons for potential future exposure. Particular attention is paid to the liquidity of derivatives markets and products in which we trade with the objective of ensuring that there are no undue concentrations of activity and risk.

The board

Sir Brian Pitman
Chairman
Joined Lloyds Bank in 1952. A director of Lloyds Bank and chief executive from 1983 to February 1997. Group chief executive of Lloyds TSB Group from December 1995 until becoming chairman in February 1997. Aged 66.

Sir Nicholas Goodison
Deputy Chairman
A director of TSB Group since 1988 and chairman from 1989 to 1995. Deputy chairman of Lloyds TSB Group since December 1995. Deputy chairman of British Steel. Former chairman of the Stock Exchange. Aged 63.

John T Davies *(until 31 July 1998)*
Deputy Chairman
Joined Lloyds Bank in 1949. A director of Lloyds Bank since 1990, deputy chief executive from 1992 to 1994 and deputy chairman from 1994. Deputy chairman of Lloyds TSB Group since December 1995. Chairman of the Office of the Banking Ombudsman. Aged 65.

Executives

Peter B Ellwood
Group Chief Executive
Joined TSB Group in 1989. A director of TSB Group since 1990 and chief executive from 1992. Deputy group chief executive of Lloyds TSB Group from December 1995 until becoming group chief executive in February 1997. Chairman of Visa International. Former chief executive of Barclaycard. Aged 54.

Alan E Moore CBE
Deputy Group Chief Executive (until 30 April 1998: Deputy Chairman from 1 August 1998)
Joined Lloyds Bank in 1980. A director of Lloyds Bank since 1989 and deputy chief executive and treasurer since 1994. Deputy group chief executive of Lloyds TSB Group since December 1995. Former director-general of the Bahrain Monetary Agency. Aged 61.

M Kent Atkinson
Group Finance Director
Joined Bank of London & South America in 1964, which became a Lloyds Bank subsidiary in 1971. Group chief financial officer from January 1995 until becoming group finance director on 1 January 1997. Aged 52.

Michael E Fairey
Group Director, Central Services (until 28 February 1998: Deputy Group Chief Executive from 1 March 1998)
Joined TSB Group in 1991 as director of credit. Retail financial services director for IT and operations from April to December 1996 and group director, central services, from 1 January 1997. Former managing director of Barclays Direct Lending Services. Aged 49.

Andrew H Longhurst *(until 15 April 1998)*
Group Director, Customer Finance
Joined Cheltenham & Gloucester in 1967 and is currently chairman. Chief executive of C&G from 1982 to 1996. Group director, customer finance, from 1 January 1997. Aged 58.

Stephen A Maran
Group Director, Insurance & Investments
Joined Lloyds and Scottish Finance, a Lloyds Bank associate, in 1969. Chief executive of Lloyds Abbey Life (now Lloyds TSB Financial Services Holdings) since 1991. Group director, savings and investments, from 1 January 1997. Aged 57.

Gordon F Pell *(from 1 March 1998)*
Group Director, UK Retail Banking
Joined Lloyds Bank in 1971, holding a number of senior executive appointments before being appointed director of distribution, central services, from January 1997. Group director, UK retail banking from 1 March 1998. Aged 47.

David P Pritchard *(from 1 April 1998)*
Group Director, Wholesale Markets & International Banking
Joined TSB Group in 1995 as group treasurer. Seconded to The Securities and Investments Board in 1996. Group director, wholesale markets & international banking from 1 April 1998. Previously held senior executive positions with the Royal Bank of Canada and Citicorp. Aged 53.

Non-executive directors

Gordon A Anderson*
Chairman of TSB Bank Scotland
A director of TSB Group since 1993. Former deputy senior partner of Ernst & Young and former president of the Institute of Chartered Accountants of Scotland. Aged 66.

A Clive Butler†
A director of TSB Group since 1993. Director of Unilever. Aged 51.

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. Former director of human resources at Reed Elsevier (UK). Aged 51.

Sir Simon Hornby
A director of Lloyds Bank from 1988 to December 1995. Former chairman of W H Smith Group and Lloyds Abbey Life. Aged 63.

L E (Paddy) Linaker*
A director of TSB Group since 1994. Director of Wolverhampton and Dudley Breweries. Former chairman of Fisons and former deputy chairman and group managing director of M&G Group. Aged 63.

Peter C Nicholson*†
A director of Lloyds Bank from 1990 to December 1995. Director of Crest Nicholson and chairman of Carisbrooke Shipping. Aged 63.

Dame Bridget Ogilvie DBE ScD
A director of Lloyds Bank from March to December 1995. Director of the Wellcome Trust and Zeneca Group. Aged 59.

Sir David Plastow‡
Deputy chairman of TSB Group from 1991 to December 1995. Chairman of the Medical Research Council and a director of Tenneco Inc. Former chairman of Vickers and Inchcape and former deputy chairman of Guinness and BUPA. Aged 65.

Sir Ian Prosser**
A director of Lloyds Bank from 1988 to December 1995. Chairman and chief executive of Bass and a director of The British Petroleum Company. Aged 54.

Sir Michael Quinlan GCB† *(until 15 April 1998)*
A director of Lloyds Bank from 1992 to December 1995. Director of the Ditchley Foundation and Pilkington. Former permanent secretary at the Department of Employment and the Ministry of Defence. Aged 67.

John M Raisman CBE LLD* *(until 15 April 1998)*
A director of Lloyds Bank from 1985 to December 1995. Chairman of British Bio-Tech and The Council for Industry and Higher Education. Director of Candover Investments. Former chairman and chief executive of Shell UK and former deputy chairman of British Telecommunications. Aged 69.

The Earl of Selborne KBE FRS
Chairman of The Agricultural Mortgage Corporation
A director of Lloyds Bank from 1994 to December 1995. Managing director of The Blackmoor Estate. Aged 57.

Company Secretary
A J Michie

* *Member of the audit committee*
** *Chairman of the audit committee*
† *Member of the remuneration committee*
‡ *Chairman of the remuneration committee*

Directors' report

Results and dividends

The consolidated profit and loss account on page 43 shows a profit attributable to shareholders for the year ended 31 December 1997 of £2,335 million.

An interim dividend of 5.3p per ordinary share was paid on 10 October 1997. The directors recommend a final dividend of 11.9p per ordinary share which, subject to approval at the annual general meeting on 15 April 1998, will be paid on 1 May 1998. The dividends for 1997 will absorb £925 million.

Principal activities

The Company is a holding company and its subsidiaries provide a comprehensive 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 9 and in the financial review on pages 13 to 32.

Authority to purchase shares

The authority for the Company to purchase, in the market, up to 543 million of its shares, representing some 10 per cent of the issued 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

Brief biographical details of directors are shown on page 33. Particulars of their emoluments and interests in shares in the Company are given on pages 38 to 40.

Sir Robin Ibbs retired on 7 February 1997 and Mr Bays, Mr Gildersleeve, Sir Richard Greenbury and Mr Swainson left the board at the annual general meeting in April 1997. Mr Longhurst, Sir Michael Quinlan and Mr Raisman will leave the board at the annual general meeting in 1998.

Mr Pell and Mr Pritchard join the board on 1 March and 1 April 1998 respectively. Under the articles of association these new directors offer themselves for election at the annual general meeting. Mr Butler, Sir Simon Hornby, Mr Moore, Mr Nicholson, Dame Bridget Ogilvie and Sir Brian Pitman 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 or marital status.

In the UK, the Group supports Opportunity 2000 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 and career development of disabled staff.

Employees are kept closely involved in major changes affecting them through team meetings, briefings, internal communications and opinion surveys.

There are well established procedures, including regular meetings with the unions, to ensure that the views of employees are taken into account in reaching decisions.

Financial involvement in the Group is encouraged through profit sharing and share option schemes.

Donations

The 1997 results include a charge for charitable donations totalling £21,446,000 (1996: £13,930,000) including £21,207,000 (1996: £13,353,000) under deeds of covenant to the four Lloyds TSB Foundations, which will be paid during 1998. No payments were made to political parties.

Policy and practice on payment of creditors

The Company's policy is to agree terms of payment with suppliers and these normally provide for payment 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 1997, the number of days to be shown in this report, to comply with the provisions of paragraph 12(3) of part VI of schedule 7 to the Companies Act 1985, is nil. The equivalent figure for the Lloyds TSB Group in the UK is 26. 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 1997 bears to the aggregate of the amounts invoiced by suppliers during the year.

Auditors

Resolutions concerning the re-appointment of Price Waterhouse as auditors and authorising the directors to set their remuneration will be submitted to the annual general meeting.

On behalf of the board

A J Michie
Secretary

12 February 1998

Report of the remuneration committee

Committee's composition

The remuneration committee of the board comprises five non-executive directors as follows:
Sir David Plastow (chairman)
Mr A C Butler
Miss S M Forbes
Mr P C Nicholson
Sir Michael Quinlan

Role of the committee

The committee reviews and determines the remuneration of the chairman, deputy chairmen, executive directors and certain other senior executives in the Group. The chairman and the group chief executive are invited to meetings of the committee, but do not attend for the discussions relating to their own remuneration.

Given that the board is ultimately responsible for all aspects of the Company and that directors' remuneration should not be an exception, all the non-executive directors receive copies of the minutes of the committee's meetings and have the opportunity to comment and have their views taken into account before the committee's decisions are implemented.

Directors' remuneration policy

In framing its remuneration policy, the committee has considered fully the provisions of section B of the annex to the listing rules of the stock exchange.

The committee aims to ensure that the remuneration arrangements 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.

At the beginning of the year, with help from independent advisers, the committee agreed adjustments to the salaries of Sir Brian Pitman and Mr Ellwood, on their appointments as chairman and group chief executive respectively. Salaries were also approved for Mr Moore and the new executive directors, Mr Atkinson, Mr Fairey, Mr Longhurst and Mr Maran, to recognise their greater responsibilities.

Long-term rewards

The Group is committed to the governing objective of maximising shareholder return. The committee believes that the executive share option schemes for senior executives, approved by the shareholders at the annual general meeting last year, provide an effective method of giving executives the incentive to achieve that objective.

Before recommending these schemes the committee considered introducing a more complicated long-term incentive plan, similar to that adopted by some other companies. However, it was decided to recommend the executive share option schemes, which would be easily understood by executives and shareholders, and which would align their interests.

Options may be granted to executive directors and senior executives within limits set by the rules of the schemes. These limits relate to the number of shares under option and the price payable on the exercise of options. The aggregate price, set at the date of grant, must not exceed four times the executive's annual remuneration and, normally, the limit for the grant of options to an executive in any one year would be equal to one year's remuneration. Performance conditions are set by the committee when a grant of options is made, and these options cannot normally be exercised unless the committee is satisfied that the conditions have been met. To meet the current 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, should be in the top fifty companies in the FTSE 100. There must also have been growth in earnings per share that is at least equal to the aggregate percentage change in the retail price index, plus two percentage points for each complete year of the relevant period. These are the performance conditions which were stated when the shareholders approved the schemes at the annual general meeting in 1997.

Short-term rewards

Each executive director is eligible for an annual incentive award opportunity equal to 50 per cent of salary, linked to the performance of the business. The awards for the group chief executive and group finance director are entirely based on Group performance. Other executive directors have half their award linked to Group performance and the other half linked to the performance of the sector of the business for which they have responsibility. The awards are normally based on the attainment of predetermined financial and other targets, such as total expenses, economic profit, minimum total capital ratios, total revenue, sales and service standards, and specific projects.

Pensions

Executive directors, other than Mr Longhurst, 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.
Mr Longhurst's current employment with the Group is not pensionable, although he receives a pension for his past services with Cheltenham & Gloucester.

Service contracts

Mr Ellwood, Mr Fairey, Sir Nicholas Goodison and Mr Maran each has a service agreement which the Company may terminate by giving one year's notice. None of the other directors has a service contract with a notice period of one year or more.

Directors' emoluments

	Salaries/fees £000	Other benefits £000	Performance-related payments £000	Profit sharing £000	1997 Total £000	1996 £000
Current directors who served during 1997:						
G A Anderson	44				44	44
M K Atkinson	250	16	116	26	408	–
A C Butler	24				24	21
J T Davies	175	10		18	203	201
P B Ellwood	435	15	202	48	700	1,209
M E Fairey	290	16	137	30	473	–
S M Forbes	34				34	26
Sir Nicholas Goodison	260	73*		27	360	360
Sir Simon Hornby	71	50†			121	116
L E Linaker	34				34	26
A H Longhurst	289	14‡	129	30	462	–
S A Maran	289	16	105	30	440	–
A E Moore	330	11	147	35	523	490
P C Nicholson	31				31	31
Dame Bridget Ogilvie	21				21	21
Sir Brian Pitman	370	36‡	24	37	467	874
Sir David Plastow	29				29	29
Sir Ian Prosser	29				29	29
Sir Michael Quinlan	26				26	26
J M Raisman	26				26	26
Lord Selborne	42				42	35
Former directors who served during 1997:						
J N Bays	20				20	67
J Gildersleeve	6				6	21
Sir Richard Greenbury	6				6	21
Sir Robin Ibbs	35	293⬦		4	332	487
E Swainson	13				13	45
	3,179	550	860	285	4,874	4,205

'Other benefits' include the use of a car and medical cover.

* Includes the payment mentioned below and on page 39 relating to a retirement annuity plan.

† During the year, Sir Simon Hornby received a bonus of £50,000 for his considerable efforts as chairman of Lloyds Abbey Life for the previous five and a half years.

‡ Includes the annual cost of life insurance cover similar to that provided for employees by the Lloyds Bank pension scheme.

⬦ Includes the £291,000 commutation of the previous Chairman's pension, mentioned in last year's report.

The total for the highest paid director (Sir Nicholas Goodison), including the £5,196,000 gain on the exercise of share options, mentioned in the table on page 40, and a payment of £58,500 relating to a retirement annuity plan was £5,556,000 (the total for the highest paid director in 1996 (Sir Brian Pitman), including the gain of £1,625,000 on the exercise of share options, was £2,499,000). The 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 1997 £	(b) Increase in transfer value (excluding inflation) £	(c) Accrued pension entitlement at 31 December 1997 £
M K Atkinson	53,486	676,378	131,476
P B Ellwood	31,596	475,530	160,694
M E Fairey	8,712*	119,247	32,002
S A Maran	23,026	338,630	170,752
A E Moore	10,159	150,600	211,720

Column (a) above is the increase in pension built up during the year. It recognises (i) the accrual rate for the additional year's 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) if the pension was transferred on leaving the Company to another pension scheme, based on factors supplied by the pension scheme actuary in accordance with actuarial guidance note GN11, less (where paid) director's contributions.

Column (c) is the aggregate pension entitlement based on pensionable service with the Company to 31 December 1997 but payable at normal retirement age.

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

* Includes additional benefits from the separate fund, mentioned in previous annual reports, 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.

On appointment to the board, Mr Maran's pension was augmented to two thirds of final salary at age 60 at a cost of £305,000.

As in previous years, Sir Nicholas Goodison received a payment, equivalent to 22.5 per cent of his salary to enable him to contribute to a retirement annuity plan. If the plan does not provide Sir Nicholas with a pension at age 65 equal to two thirds of final salary, the Group has undertaken to make up the difference, subject to a maximum annual payment by the Group equivalent to 31.67 per cent of his final salary. Provision has been made by the Group, which, at 31 December 1997, represents an accrued pension of £70,982 per annum (ie 27.3 per cent of his current salary).

Directors' interests

The interests, all beneficial, of directors in the capital of Lloyds TSB Group were:

Shares:	At 31 December 1997	At 1 January 1997
G A Anderson	2,000	2,000
M K Atkinson	26,181	22,537
A C Butler	2,000	2,000
J T Davies	596,995	809,439
P B Ellwood	167,924	157,068
M E Fairey	61,189	7,795
S M Forbes	2,000	2,000
Sir Nicholas Goodison	840,500	60,525
Sir Simon Hornby	4,913	4,913
L E Linaker	5,000	5,000
A H Longhurst	2,736	2,736

	At 31 December 1997	At 1 January 1997
S A Maran	297,143	293,202
A E Moore	689,727	686,618
P C Nicholson	2,704	2,704
Dame Bridget Ogilvie	976	976
Sir Brian Pitman	2,081,193	2,075,917
Sir David Plastow	22,000	22,000
Sir Ian Prosser	4,253	4,253
Sir Michael Quinlan	3,224	3,146
J M Raisman	29,709	28,989
Lord Selborne	3,372	3,372

Two directors had non-beneficial interests as follows:

Sir Nicholas Goodison	54,690	54,690
Sir Simon Hornby	18,928	18,928

Directors' interests (continued)

Options to acquire shares:

	At 1 January 1997	Granted during the year	Exercised during the year	At 31 December 1997	Weighted average exercise price at 31 December 1997	Exercise price of options granted or exercised during the year	Market price at date of exercise	Amount of gain on exercise** 1997 £000	1996 £000
M K Atkinson	211,018	50,000		259,812	258p	510p			
		356				580p			
			1,562			115.01p	675.5p	9	
J T Davies	4,874	3,731		4,696	362p	416p			
			3,909			115.01p	583.5p	18	1,206
P B Ellwood*	302,136	110,000		325,486	359p	510p			
		4,146				416p			
			90,796			282.5p	552p	309	318
M E Fairey*	407,946	54,000		236,064	310p	510p			
			52,389			282.5p	552p	178	
			173,493			207.5p	711p	986	
Sir Nicholas Goodison*	897,735	1,681		119,264	197p	580p			
			95,563			146.5p	730p	628	
			119,076			162.5p	730p	763	
			546,000			125p	730p	3,703	
			19,513			282.5p	730p	102	
A H Longhurst	696,818	23,000		719,818	326p	510p			
S A Maran†		62,000		68,071	478p	510p			
		3,941	3,941			90.2p	741.5p	26	
		716				168.8p			
		3,673				139p			
		1,682				160.4p			
A E Moore	415,010		1,562	413,448	192p	115.01p	583.5p	7	
Sir Brian Pitman	494,969	497		493,904	197p	416p			
			1,562			115.01p	583.5p	7	1,625
								6,736	3,149

Options outstanding are exercisable between 1998 and 2007.

* 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 following the merger with Lloyds Bank, but which was not paid to optionholders. In that regard Mr Ellwood received 11,687 additional shares, Mr Fairey received 22,614 additional shares and Sir Nicholas Goodison received 78,276 additional shares when they exercised the share options shown above.

** 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.

† On 1 January 1997 Mr Maran held options over 6,166 shares in Lloyds Abbey Life. These were exchanged for options over 10,012 shares in Lloyds TSB Group, following the scheme of arrangement by which Lloyds Abbey Life became a wholly owned subsidiary of Lloyds TSB Group.

The market price for a share in the Company at 31 December 1997 was 789p. The range of prices between 1 January 1997 and 31 December 1997 was 428p to 850.5p.

None of the other directors at 31 December 1997 had options to acquire shares in the Company or its subsidiaries.

No director had any other interest in the capital of the Company or its subsidiaries.

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

There were no changes in these interests between 31 December 1997 and 12 February 1998.

On behalf of the board

Sir David Plastow
Chairman of the remuneration committee

12 February 1998

Corporate governance

The board has reviewed the code of best practice published in December 1992 by the Committee on the Financial Aspects of Corporate Governance (the Cadbury Committee). The Company has complied with the provisions of the code throughout the year.

The Company has also complied throughout the year with section A of the best practice provisions annexed to the stock exchange listing rules, relating to directors' remuneration, except for that relating to the powers of the remuneration committee of the board. However, the committee's terms of reference were changed in July, following a review, and the Company now complies fully with these best practice provisions. The committee's terms of reference are described on page 36.

Statement of 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 43 to 64, 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.

Statement of 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 and financial reporting

The board of directors is responsible for the Group's system of internal financial control which is designed to ensure effective and efficient operations, internal financial control and compliance with laws and regulations. In establishing the system of internal financial control the directors have regard to the materiality of the relevant financial risk, the likelihood of a loss being incurred and the costs of control. It follows, therefore, that the system of internal financial control can only provide reasonable but not absolute assurance against the risk of material misstatement or 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 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 to the board monthly detailing the results of each principal business unit, variances against budget and prior year and other performance data.

The effectiveness of the internal control system is reviewed annually by the audit committee of the board which also receives reports of reviews undertaken around the Group by the Group's internal audit function, including the compliance department. The audit committee also receives reports from the Company's auditors, Price Waterhouse, which include details of any significant internal financial control matters.

Auditors' reports

Auditors' report on the financial statements

To the members of Lloyds TSB Group plc.

We have audited the financial statements on pages 38 to 40 and 43 to 64 which have been prepared under the historical cost convention, as modified by the revaluation of investments and premises and the accounting policies set out on pages 49 and 50.

Respective responsibilities of directors and auditors

As described on page 41, the Company's directors are responsible for the preparation of the financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of 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 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 1997 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.

Price Waterhouse
Chartered Accountants
and Registered Auditors
London

12 February 1998

Auditors' report on corporate governance matters

To the directors of Lloyds TSB Group plc.

In addition to our audit of the financial statements we have reviewed your statement on page 41 concerning the Group's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange and the adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with Listing Rules 12.43(j) and 12.43(v), if not otherwise disclosed.

Basis of opinion

We carried out our review having regard to the guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary for us to express any opinion, and we do not do so, on the effectiveness of either the Group's system of internal financial control or corporate governance procedures nor on the ability of the Group to continue in operational existence.

Opinion

In our opinion, your statements on internal financial controls and on going concern have provided the disclosures required by the Listing Rules referred to above and are consistent with the information which came to our attention as a result of our audit work on the financial statements.

In our opinion, based on enquiry of certain directors and officers of the Company and examination of relevant documents, your statement appropriately reflects the Group's compliance with the other aspects of the Code specified for our review by Listing Rule 12.43(j).

Price Waterhouse
Chartered Accountants
London

12 February 1998

Consolidated profit and loss account

for the year ended 31 December 1997

	Note	1997 £ million	1996 £ million
Interest receivable:			
Interest receivable and similar income arising from debt securities		**572**	676
Other interest receivable and similar income		**9,616**	8,761
Interest payable		**6,016**	5,668
Write-down of finance lease receivables	7	**58**	–
Net interest income		**4,114**	3,769
Other income			
Dividend income from equity shares		**10**	10
Fees and commissions receivable		**2,382**	2,204
Fees and commissions payable		**(317)**	(269)
Dealing profits (before expenses)		**223**	217
Income from long-term assurance business	31	**328**	403
General insurance premium income		**284**	261
Other operating income		**206**	167
		3,116	2,993
Total income		**7,230**	6,762
Operating expenses			
Administrative expenses	2	**3,429**	3,525
Restructuring provision	3	**–**	75
Total administrative expenses		**3,429**	3,600
Depreciation	25	**247**	254
		3,676	3,854
Trading surplus		**3,554**	2,908
General insurance claims		**145**	120
Provisions for bad and doubtful debts	17		
Specific		**418**	357
General		**3**	(30)
		421	327
Amounts written off fixed asset investments	4	**3**	5
Operating profit		**2,985**	2,456
Income from associated undertakings		**23**	84
Profit on sale of fixed asset investments	5	**–**	42
Profit (loss) on sale of businesses	6	**154**	(77)
Profit on ordinary activities before tax	8	**3,162**	2,505
Tax on profit on ordinary activities	10	**813**	786
Profit on ordinary activities after tax		**2,349**	1,719
Minority interests (equity)		**14**	144
Profit for the year attributable to shareholders	11	**2,335**	1,575
Dividends	12	**925**	692
Retained profit	43	**1,410**	883
Earnings per share	13	**43.7p**	31.2p

Consolidated balance sheet
at 31 December 1997

	Note	1997 £ million	1996 £ million
Assets			
Cash and balances at central banks		**881**	1,272
Items in course of collection from banks		**1,845**	1,963
Treasury bills and other eligible bills	14	**3,569**	3,204
Loans and advances to banks	15	**20,657**	14,924
Loans and advances to customers	16	**87,962**	86,219
Debt securities	20	**12,534**	10,551
Equity shares	21	**221**	274
Interests in associated undertakings	23	**25**	142
Tangible fixed assets	25	**1,699**	1,962
Own shares	28	**36**	47
Other assets	29	**4,311**	4,646
Prepayments and accrued income	30	**2,478**	2,374
Long-term assurance business attributable to shareholders	31	**1,842**	1,650
		138,060	129,228
Long-term assurance assets attributable to policyholders	31	**20,046**	18,139
Total assets		**158,106**	147,367

The directors approved the accounts on 12 February 1998.

Sir Brian Pitman	**P B Ellwood**	**M K Atkinson**
Chairman	*Group Chief Executive*	*Group Finance Director*

Brian Pitman

	Note	1997 £ million	1996 £ million
Liabilities			
Deposits by banks	33	**16,571**	14,560
Customer accounts	34	**85,404**	81,643
Items in course of transmission to banks		**845**	940
Debt securities in issue	35	**12,025**	11,226
Other liabilities	37	**8,375**	7,895
Accruals and deferred income	38	**3,264**	2,804
Provisions for liabilities and charges:			
Deferred tax	39	**436**	307
Other provisions for liabilities and charges	40	**637**	826
Subordinated liabilities:			
Undated loan capital	41	**1,515**	1,384
Dated loan capital	41	**2,694**	2,535
Minority interests (equity)		**40**	34
Called-up share capital	42	**1,369**	1,358
Share premium account	43	**70**	42
Revaluation reserve	43	**(216)**	(163)
Merger reserve	43	**343**	343
Profit and loss account	43	**4,688**	3,494
Shareholders' funds (equity)		**6,254**	5,074
		138,060	129,228
Long-term assurance liabilities to policyholders		**20,046**	18,139
Total liabilities		**158,106**	147,367
Memorandum items	45		
Contingent liabilities:			
Acceptances and endorsements		**456**	663
Guarantees and assets pledged as collateral security		**2,142**	1,762
Other contingent liabilities		**1,655**	1,924
		4,253	4,349
Commitments:			
Commitments arising out of sale and option to resell transactions		**13**	9
Other commitments		**24,528**	23,979
		24,541	23,988

Company balance sheet
at 31 December 1997

	Note	1997 £ million	1996 £ million
Fixed assets			
Investments			
Shares in group undertakings	24	**7,863**	5,591
Loans to group undertakings	24	**1,249**	1,861
Own shares	28	**36**	47
		9,148	7,499
Current assets			
Debtors falling due within one year			
Amounts owed by group undertakings		**1,144**	715
Other debtors		**12**	5
Tax recoverable		**59**	149
Cash balances with group undertakings		**226**	136
		1,441	1,005
Current liabilities			
Amounts falling due within one year			
Dated loan capital	41	**125**	–
Short-term borrowings	36	**202**	205
Amounts owed to group undertakings		**2,632**	1,254
Other creditors		**55**	72
Dividend payable		**642**	478
		3,656	2,009
Net current liabilities		**(2,215)**	(1,004)
Total assets less current liabilities		**6,933**	6,495
Creditors			
Amounts falling due after more than one year			
Undated loan capital	41	**–**	100
Dated loan capital	41	**694**	1,006
		694	1,106
Net assets		**6,239**	5,389
Capital and reserves			
Called-up share capital	42	**1,369**	1,358
Share premium account	43	**70**	42
Revaluation reserve	43	**2,895**	2,688
Profit and loss account	43	**1,905**	1,301
Shareholders' funds (equity)		**6,239**	5,389

The directors approved the accounts on 12 February 1998.

Sir Brian Pitman
Chairman
Brian Pitman

P B Ellwood
Group Chief Executive

M K Atkinson
Group Finance Director

Other statements

Statement of total recognised gains and losses

for the year ended 31 December 1997

	1997 £ million	1996 £ million
Profit attributable to shareholders	**2,335**	1,575
Premises revaluation deficit	**(118)**	–
Currency translation differences on foreign currency net investments	**(83)**	(85)
Total recognised gains and losses relating to the year	**2,134**	1,490

Historical cost profits and losses

for the year ended 31 December 1997

	1997 £ million	1996 £ million
Profit on ordinary activities before tax	**3,162**	2,505
Realisation of premises revaluation deficit	**(65)**	(6)
Historical cost profit on ordinary activities before tax	**3,097**	2,499
Historical cost profit for the year retained after tax, minority interests and dividends	**1,345**	877

Reconciliation of movements in shareholders' funds

for the year ended 31 December 1997

	1997 £ million	1996 £ million
Profit attributable to shareholders	**2,335**	1,575
Dividends	**(925)**	(692)
Retained profit	**1,410**	883
Premises revaluation deficit	**(118)**	-
Currency translation differences on foreign currency net investments	**(83)**	(85)
Issue of shares	**102**	1,065
Premiums on acquisitions	**(164)**	(1,077)
Goodwill written back on sale of businesses	**33**	79
Net increase in shareholders' funds	**1,180**	865
Shareholders' funds at beginning of year	**5,074**	4,209
Shareholders' funds at end of year	**6,254**	5,074

Consolidated cash flow statement

for the year ended 31 December 1997

	1997 £ million	1996 £ million
Net cash (outflow) inflow from operating activities (note 48a)	**(654)**	227
Returns on investments and servicing of finance:		
Dividends received from associated undertakings	**13**	47
Dividends paid to minority shareholders in group undertakings	**(8)**	(191)
Interest paid on subordinated liabilities (loan capital)	**(278)**	(265)
Interest element of finance lease rental payments	**(1)**	(2)
Net cash outflow from returns on investments and servicing of finance	**(274)**	(411)
Taxation:		
UK corporation tax	**(199)**	(556)
Overseas tax	**(62)**	(59)
Total taxation	**(261)**	(615)
Capital expenditure and financial investment:		
Additions to fixed asset investments	**(28,621)**	(31,724)
Disposals of fixed asset investments	**30,305**	35,758
Additions to tangible fixed assets	**(264)**	(242)
Disposals of tangible fixed assets	**171**	329
Net cash inflow from capital expenditure and financial investment	**1,591**	4,121
Acquisitions and disposals:		
Addition to interests in associated undertakings	**(9)**	(4)
Acquisition of group undertakings (note 48e)	**(46)**	–
Disposal of group undertakings and businesses (note 48g)	**436**	3
Purchase of shares from minority shareholders	**–**	(683)
Net cash inflow (outflow) from acquisitions and disposals	**381**	(684)
Equity dividends paid	**(698)**	(1,566)
Net cash inflow before financing	**85**	1,072
Financing:		
Issue of subordinated liabilities (loan capital)	**496**	557
Issue of ordinary share capital	**39**	32
Repayments of subordinated liabilities (loan capital)	**(220)**	(320)
Capital element of finance lease rental payments	**(5)**	(17)
Net cash inflow from financing	**310**	252
Increase in cash (note 48c)	**395**	1,324

Notes to the accounts

1 Accounting policies

Accounting policies are unchanged from 1996.

The presentation of dealing profits has been changed to give an improved analysis of results. It now includes interest, dividends and funding costs related to trading activities. As a result of this change, dealing profits in 1997 have been increased by £154 million (1996: £121 million) and net interest income and dividend income from equity shares have been reduced by a corresponding amount. Comparative 1996 figures have been restated to reflect the new presentation.

In addition, in 1997 the Group has implemented the requirements of Financial Reporting Standard 1 (revised 1996) "Cash Flow Statements" and the 1996 comparative figures have been restated accordingly.

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, and premises (see **f** and **i**) in compliance with Sections 255 and 255A, Schedule 9 and other requirements of the Companies Act 1985, in accordance with applicable accounting standards and with the Statements of Recommended Accounting Practice issued by the British Bankers Association. The accounts of the Company are prepared under the historical cost convention as modified by the revaluation of shares in group undertakings (see **g**), in compliance with Section 226, Schedule 4 and other requirements of the Companies Act 1985 and in accordance with applicable accounting standards.

b Basis of consolidation

Assets, liabilities and results of group undertakings and the share of results of associated undertakings 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 shareholders' and policyholders' interests in the long-term assurance business, the value of long-term assurance business attributable to shareholders and the assets and liabilities attributable to policyholders are classified under separate headings in the consolidated balance sheet.

c Premiums on acquisitions

Premiums arising on acquisitions of or by group and associated undertakings are taken direct to reserves in the year of acquisition. The gain or loss on disposal of a group undertaking is calculated by comparing the carrying value of the net assets sold and the related premium with the proceeds received.

d Provisions for bad and doubtful debts and interest in suspense

Provisions for bad and doubtful debts are based on the year-end appraisal of advances. The specific element relates to identified risk advances, whereas the general element relates to latent bad and doubtful debts which are present in any portfolio of bank advances but have not been specifically identified.

Advances are written down to estimated realisable value when the normal banking relationship with the customer has ceased; where it is doubtful that interest earned on loans and advances will be collectable, it is credited to an interest in suspense account and is only released to the profit and loss account when its collectability is no longer subject to significant doubt.

e 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.

f Debt securities and equity shares

Premiums and discounts on debt securities, apart from those held for dealing purposes, are amortised from purchase to maturity in equal annual instalments. Debt securities acquired in exchange for advances to countries experiencing payment difficulties, either collateralised or due to be collateralised by US Treasury securities, 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. Debt securities and equity shares held for dealing purposes are included at market value. Investments held within the long-term assurance fund are included on the following basis: stocks, shares, fixed interest securities and unit trusts held for unit linked funds are valued in accordance with policy conditions at market prices; other stocks and shares and fixed interest 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 31 December 1997, and mortgages and loans are at cost less amounts written off.

g 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**.

h Interests in associated undertakings

Interests in associated undertakings are stated at the Group's share of the net tangible assets of the relevant undertakings.

i Tangible fixed assets

Freeholds and long leaseholds are included at the last valuation on the basis of existing use value. Short leaseholds (50 years or less) and equipment 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 maintained in a state of good repair and it is considered that residual values, based on prices prevailing at the time of acquisition or subsequent valuation, are such that depreciation is not significant. 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 computers, motor vehicles and other equipment are 3-8 years.

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

Leasing income 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 calculated by the sum of the digits method.

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.

1 Accounting policies (continued)

m Pensions and other post-retirement benefits

Contributions to the Group's pension schemes are 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. Pension arrangements for most of the staff in the UK and for the majority of those overseas are operated through defined benefit schemes funded by Group companies. The pension cost relating to these schemes 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. Arrangements for pensions of certain staff employed overseas who are not included in funded schemes are made in accordance with local regulations and custom.

The cost of providing post-retirement benefits other than pensions is charged to the profit and loss account on a systematic basis over employees' working lives. The unfunded liability is included in provisions 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, offset by those on any related currency borrowings, 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

The value placed on the Group's long-term assurance business attributable to shareholders represents a prudent valuation of future earnings of policies in force, together with the net worth of the business, being the net tangible assets and the surplus retained within the long-term assurance funds. This value is determined annually in consultation with independent actuaries and is included separately in the balance sheet.

Changes in the value placed on long-term assurance business attributable to shareholders, 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.

p General insurance business

The underwriting result of the general insurance business is determined annually and included in profit before tax after taking into account premiums, outstanding claims and deferred acquisition costs. Premiums are included net of refunds and a provision for the proportion of premiums written in the year which relate to cover provided for future periods. The provision for claims includes the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date, and is after anticipated recoveries from reinsurers and others.

q Off-balance sheet instruments

Off-balance sheet instruments used in trading activities are carried at market value. Profits and losses on instruments which are being used to hedge exposures are recognised in a manner that reflects the accounting treatment of the assets or liabilities being hedged.

2 Administrative expenses	1997 £m	1996 £m
Salaries and profit sharing	**1,799**	1,948
Social security costs	**138**	135
Other pension costs	**(90)**	(58)
Staff costs	**1,847**	2,025
Other administrative expenses	**1,582**	1,500
	3,429	3,525

2 Administrative expenses (continued)

The average number of persons on a headcount basis employed by the Group during the year was as follows:	1997	1996
UK	**82,098**	86,418
Overseas	**10,557**	8,265
	92,655	94,683

Details of directors' emoluments are given on pages 38 to 40 in the report of the remuneration committee.

The auditors' remuneration was £3,958,000 (1996: £4,387,000), of which £50,000 (1996: £50,000) related to the holding company. Fees paid to Price Waterhouse in respect of non-audit services were £9,150,000 (1996: £2,711,000), of which £6,175,000 (1996: £2,016,000) related to UK companies. Non-audit fees comprise management consultancy of £4,750,000 (1996: £1,296,000) and regulatory and other advisory work of £4,400,000 (1996: £1,415,000).

There was a net credit in respect of pension costs for the Group in 1997 of £90 million (1996: credit of £58 million), which included a credit of £59 million (1996: credit of £38 million) relating to the Lloyds Bank pension scheme and a credit of £52 million (1996: £44 million) relating to the TSB Group pension scheme.

Full actuarial valuations of the Lloyds Bank pension scheme are carried out every three years with interim reviews in the intervening years. At 30 June 1996, the date of the latest full actuarial valuation, the principal actuarial assumptions adopted were that, over the long term, the annual rate of return on new investments would be 2.5 per cent higher than the annual increase in pensionable remuneration, 5 per cent higher than the annual increase in present and future pensions in payment, and 4.5 per cent higher than the annual increase in dividends receivable. The market value of the assets of the main scheme at this date was £5,250 million. The actuarial value of the assets represented 132 per cent of the accrued liabilities allowing for future increases in pensions and pensionable remuneration. For funding purposes, the surplus in the Lloyds Bank pension scheme is being eliminated by means of a contribution holiday.

The latest full actuarial valuation of the TSB Group pension scheme was also carried out as at 30 June 1996. The principal actuarial assumptions adopted were that, over the long term, the annual rate of return on new investments would be 2.5 per cent higher than the annual increase in pensionable remuneration, between 4.5 and 5 per cent higher than the annual increase in present and future pensions in payment, depending on members' entitlements, and 4.5 per cent higher than the annual increase in dividends receivable. The market value of the assets of the scheme at this date was £2,820 million. The actuarial value of the assets represented 148 per cent of the accrued liabilities allowing for future increases in pensions and pensionable remuneration. For funding purposes the surplus in the TSB Group pension scheme is being eliminated by means of a contribution holiday.

Contribution rates to other schemes have been adjusted to take account of surpluses and deficiencies. The pensions prepayment of £405 million (1996: £288 million) for the Group is included in prepayments and accrued income.

The Group operates a number of schemes which provide post-retirement health care benefits to certain employees, retired employees and their dependent relatives. The total cost for the Group in 1997 was £3 million (1996: £8 million). The latest actuarial valuation of the liability was carried out at 31 December 1997. This valuation showed the Group's liability to be £57 million, which had been fully provided for at 31 December 1997. 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 4.5 per cent and 2.5 per cent respectively higher than annual price inflation.

3 Restructuring provision

The restructuring provision of £75 million (tax credit: £20 million) made in 1996 was to cover the cost of reorganising the Lloyds Abbey Life sub-group following the acquisition of the minority shareholders' interest.

4 Amounts written off fixed asset investments

	1997 £m	1996 £m
Debt securities	3	4
Equity shares	–	1
	3	5

5 Profit on sale of fixed asset investments

During 1996, the Group disposed of its investment in Macquarie Bank Limited, resulting in a profit of £42 million (tax: nil).

6 Profit (loss) before tax on sale of businesses

	1997 £m	1996 £m
Profit on sale of Mortgage Express Limited (after charging goodwill of £8 million previously written off to reserves) (tax: nil)	52	–
Profit on sale of Schröder Münchmeyer Hengst & Co (after charging goodwill of £3 million previously written off to reserves) (tax: £14 million)	32	–
Profit on sale of the Business Technology Finance Division of Lloyds UDT Limited (after charging goodwill of £13 million previously written off to reserves) (tax: £12 million)	25	–
Profit on sale of 49.9 per cent interest in Cardnet (tax: nil)	30	–
Profit on sale of Endeavour Personal Finance Limited (tax: nil)	24	–
Loss on sale of commercial business of Black Horse Agencies Limited (after charging goodwill of £9 million previously written off to reserves) (tax: nil)	(9)	–
Loss on sale of the Corporate Finance Department of Hill Samuel Bank Limited (after charging goodwill of £69 million previously written off to reserves) (tax: nil)	–	(68)
Loss on sale of Atlanta Capital Management (after charging goodwill of £10 million previously written off to reserves) (tax: nil)	–	(9)
	154	(77)

The amounts included in the consolidated profit and loss account in respect of these businesses up to the date of the sale are not material.

In January 1998 International Factors Limited was sold. This produced a profit before tax of approximately £160 million (tax: nil), which will be included in the accounts for the year ending 31 December 1998.

7 Write-down of finance lease receivables

Following the reduction in the corporation tax rate from 33 per cent to 31 per cent from 1 April 1997, the deferred tax liability in respect of the leasing business of Lloyds Leasing has reduced by £58 million. However, as the benefit of this reduction will be passed on to customers, the value of the future rentals receivable has been similarly reduced. Accordingly, both profit before tax and the tax charge have been reduced by £58 million. There is, therefore, no effect on profit attributable to shareholders.

8 Profit on ordinary activities before tax

	1997 £m	1996 £m
Profit on ordinary activities before tax is stated after taking account of:		
Income from:		
Equipment leased to customers and banks and hire purchase contracts: aggregate amounts receivable	1,944	1,844
Profit less losses from securities trading	129	78
Profit less losses on disposal of other investment securities	45	38
Charges:		
Rental of premises	210	189
Hire of equipment	45	44
Interest on subordinated liabilities (loan capital)	321	294
Finance leases: charges	1	2
: depreciation	16	20

9 Segment analysis

	Profit on ordinary activities before tax 1997 £m	1996* £m
Class of business:		
Retail Banking	832	717
Mortgages	693	522
Insurance	529	514
Retail Financial Services	2,054	1,753
Wholesale Markets	653	559
International Banking	425	375
Central group items	88	(182)
Write-down of finance lease receivables	(58)	–
	3,162	2,505

Geographical area:**	Domestic 1997 £m	International 1997 £m	Total 1997 £m
Interest receivable	7,858	2,330	10,188
Dividend income from equity shares	5	5	10
Fees and commissions receivable	2,098	284	2,382
Dealing profits (before expenses)	174	49	223
Income from long-term assurance business	328	–	328
General insurance premium income	284	–	284
Other operating income	120	86	206
Total gross income	10,867	2,754	13,621
Profit on ordinary activities before tax	2,733	429	3,162

	Domestic 1996 £m	International 1996 £m	Total 1996 £m
Interest receivable	7,489	1,948	9,437
Dividend income from equity shares	9	1	10
Fees and commissions receivable	1,934	270	2,204
Dealing profits (before expenses)	163	54	217
Income from long-term assurance business	403	–	403
General insurance premium income	261	–	261
Other operating income	99	68	167
Total gross income	10,358	2,341	12,699
Profit on ordinary activities before tax	2,164	341	2,505

9 Segment analysis (continued)

	Net assets†		Assets‡	
	1997 £m	1996* £m	**1997 £m**	1996* £m
Class of business:				
Retail Banking	**1,264**	1,070	**22,104**	22,326
Mortgages	**1,242**	1,057	**41,959**	42,782
Insurance	**2,064**	1,739	**2,683**	2,527
Retail Financial Services	**4,570**	3,866	**66,746**	67,635
Wholesale Markets	**1,464**	1,353	**53,841**	45,900
International Banking	**267**	202	**17,335**	15,557
Central group items	**(7)**	(313)	**138**	136
	6,294	5,108	**138,060**	129,228
Geographical area:**				
Domestic	**6,279**	5,326	**118,898**	111,652
International	**15**	(218)	**19,162**	17,576
	6,294	5,108	**138,060**	129,228

* 1996 figures have been restated to take account of organisational changes.

** 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 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 segment analysis of turnover is given.

10 Tax on profit on ordinary activities

	1997 £m	1996 £m
UK corporation tax	**620**	651
Relief for overseas tax	**(39)**	(50)
Overseas tax	**62**	50
Deferred tax: current year	**211**	112
: prior year adjustment relating to rate change	**(51)**	-
	803	763
Associated undertakings	**10**	23
	813	786

The charge for tax on the profit for the year is based on an average UK corporation tax rate of 31.5 per cent (1996: 33 per cent).

The UK corporation tax charge includes £97 million (1996: £92 million) in respect of notional tax on franked investment income and on the shareholders' interest in the value of the long-term assurance business.

11 Profit for the financial year attributable to shareholders

The profit attributable to shareholders includes a profit of £1,047 million (1996: £1,537 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.

12 Ordinary dividends

	1997 pence per share	1996 pence per share	**1997 £m**	1996 £m
Interim: paid	**5.3**	4.2	**283**	214
Final: proposed	**11.9**	9.0	**642**	478
	17.2	13.2	**925**	692

During 1997, £63 million (1996: £46 million) was transferred to reserves in respect of shares issued instead of cash, representing £31 million in respect of the 1996 final dividend and £32 million in respect of the 1997 interim dividend.

13 Earnings per share

	1997	1996
Profit attributable to shareholders	**£2,335m**	£1,575m
Weighted average number of ordinary shares in issue during the year*	**5,341m**	5,054m
Earnings per share	**43.7p**	31.2p

The figures for fully diluted earnings per share are not materially different.

* The weighted average number of shares for the year has been calculated after deducting 36 million (1996: 52 million) ordinary shares held by TSB Group Holdings (Jersey) Limited and the trustees of the TSB Group Employee Trust, upon which dividends have been waived (note 28).

14 Treasury bills and other eligible bills

	1997 Balance sheet £m	1997 Valuation £m	1996 Balance sheet £m	1996 Valuation £m
Investment securities:				
Treasury bills and similar securities	47	49	285	287
Other eligible bills	1,239	1,292	1,532	1,532
	1,286	1,341	1,817	1,819
Other securities:				
Treasury bills and similar securities	2,229		1,365	
Other eligible bills	54		22	
	2,283		1,387	
	3,569		3,204	
Included above:				
Unamortised discounts net of premiums on investment securities	5		12	

Movements in investment securities comprise:	Cost £m	Premiums and discounts £m	Total £m
At 1 January 1997	1,802	15	1,817
Exchange and other adjustments	(2)	1	(1)
Adjustments on acquisitions and disposals	11	–	11
Additions	12,783	–	12,783
Bills sold or matured	(13,313)	(103)	(13,416)
Amortisation of premiums and discounts	–	92	92
At 31 December 1997	1,281	5	1,286

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.

15 Loans and advances to banks

	1997 £m	1996 £m
Lending to banks	861	844
Deposits placed with banks	19,895	14,187
	20,756	15,031
Equipment leased to banks	–	1
Total loans and advances to banks	20,756	15,032
Provisions for bad and doubtful debts	(60)	(58)
Interest held in suspense	(39)	(50)
	20,657	14,924
Repayable on demand	5,277	4,502
Other loans and advances by residual maturity repayable:		
3 months or less	11,883	7,898
1 year or less but over 3 months	2,785	1,969
5 years or less but over 1 year	374	189
Over 5 years	437	474
Provisions for bad and doubtful debts	(60)	(58)
Interest held in suspense	(39)	(50)
	20,657	14,924

16 Loans and advances to customers

	1997 £m	1996 £m
Lending to customers	83,235	82,411
Hire purchase debtors	1,564	1,431
Equipment leased to customers	5,800	5,225
Total loans and advances to customers	90,599	89,067
Provisions for bad and doubtful debts	(2,433)	(2,488)
Interest held in suspense	(204)	(360)
	87,962	86,219
Loans and advances by residual maturity repayable:		
3 months or less	17,168	19,575
1 year or less but over 3 months	6,134	6,326
5 years or less but over 1 year	17,247	15,311
Over 5 years	50,050	47,855
Provisions for bad and doubtful debts	(2,433)	(2,488)
Interest held in suspense	(204)	(360)
	87,962	86,219
Of which repayable on demand or at short notice	9,237	10,450
Included above:		
Due from associated undertakings – all unsubordinated	38	29

The cost of assets acquired during the year for letting to customers under finance leases and hire purchase contracts amounted to £2,566 million (1996: £2,949 million).

17 Provisions for bad and doubtful debts

	1997 Specific £m	1997 General £m	1996 Specific £m	1996 General £m
At 1 January	2,066	480	2,652	512
Exchange and other adjustments	39	(2)	(149)	(2)
Transfer from general to specific provisions	110	(110)	–	–
Adjustments on acquisitions and disposals	43	(1)	–	–
Advances written off	(678)	–	(848)	–
Reclassification of provision for collateralised bonds	–	–	(15)	–
Recoveries of advances written off in previous years	125	–	69	–
Charge (release) to profit and loss account:				
New and additional provisions	972	14	772	12
Releases and recoveries	(554)	(11)	(415)	(42)
	418	3	357	(30)
At 31 December	2,123	370	2,066	480
	2,493		2,546	
In respect of:				
Loans and advances to banks	60		58	
Loans and advances to customers	2,433		2,488	
	2,493		2,546	

18 Interest held in suspense and non-performing lending	1997 £m	1996 £m
At 1 January	410	478
Exchange and other adjustments	(11)	(16)
Adjustments on acquisitions and disposals	(5)	–
Interest written off	(222)	(135)
Interest taken to income	(43)	(63)
Interest suspended during the year	114	146
At 31 December	243	410
In respect of:		
Loans and advances to banks	39	50
Loans and advances to customers	204	360
	243	410
Non performing lending comprises:		
Loans and advances – category 1	1,407	1,802
Loans and advances – category 2	550	709
	1,957	2,511
Provisions	(970)	(960)
Interest held in suspense	(243)	(410)
	744	1,141

Category 1:
This comprises lending 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; it is placed on a suspense account and only taken into income if there ceases to be significant doubt about its being paid.

Category 2:
This comprises lending where the operation of the customer's account has ceased. The lending is managed by specialist recovery departments and has been written down to its estimated realisable value. Interest is not added to the lending nor placed on a suspense account as its recovery is considered unlikely; it is only taken to income if it is received.

19 Concentrations of exposure	1997 £m	1996 £m
Loans and advances to customers		
Domestic:		
Agriculture, forestry and fishing	2,018	1,892
Manufacturing	3,073	3,283
Construction	789	898
Transport, distribution and hotels	3,930	3,900
Property companies	2,301	1,962
Financial, business and other services	6,386	7,392
Personal: mortgages*	41,785	40,550
: other	10,008	9.270
Lease financing	5,744	5,189
Hire purchase	1,564	1,421
Other	1,301	1,098
Total domestic	78,899	76,855
International:		
Latin America	3,307	2,991
New Zealand	5,430	5,793
Rest of the world	2,963	3.428
Total international	11,700	12,212
	90,599	89,067
Provisions for bad and doubtful debts†	(2,433)	(2,488)
Interest held in suspense†	(204)	(360)
	87,962	86.219

* Includes staff mortgages.

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

19 Concentrations of exposure (continued)

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

20 Debt securities	1997 Balance sheet £m	1997 Valuation £m	1996 Balance sheet £m	1996 Valuation £m
Investment securities:				
Government securities	1,502	1,856	3,051	3,334
Other public sector securities	42	43	104	106
Bank and building society certificates of deposit	3,474	3,475	2,524	2,559
Other debt securities	756	767	1,046	1,047
	5,774	6,141	6,725	7,046
Other securities:				
Government securities	4,535	4,535	1,915	1,915
Other public sector securities	89	89	135	135
Bank and building society certificates of deposit	78	78	140	140
Other debt securities	2,058	2,058	1,636	1,636
	12,534	12,901	10,551	10,872
Due within 1 year	4,814		3,812	
Due 1 year and over	7,720		6,739	
	12,534		10,551	
Unamortised discounts net of premiums on investment securities	845		841	
Listed: collateralised bonds	852	1,208	770	1,046
: other	7,620	7,630	6,181	6,191
Unlisted	4,062	4,063	3,600	3,635
	12,534	12,901	10,551	10,872

Movements in investment securities comprise:	Cost £m	Premiums and discounts £m	Provisions £m	Total £m
At 1 January 1997	6,532	199	6	6,725
Adjustments on acquisitions and disposals	4	–	–	4
Additions	15,802	–	–	15,802
Securities sold or matured	(16,766)	(27)	(2)	(16,791)
Charge for the year	–	–	3	(3)
Amortisation of premiums and discounts	–	37	–	37
At 31 December 1997	5,572	209	7	5,774

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.

21 Equity shares

	1997 Balance sheet £m	1997 Valuation £m	1996 Balance sheet £m	1996 Valuation £m
Investment securities:				
Listed	23	48	41	65
Unlisted	83	97	82	96
	106	145	123	161
Other securities:				
Listed	114		147	
Unlisted	1		4	
	115		151	
	221		274	

Movements in investment securities comprise:	Cost £m	Provisions £m	Total £m
At 1 January 1997	132	9	123
Exchange and other adjustments	(1)	–	(1)
Additions	36	–	36
Disposals	(53)	(1)	(52)
At 31 December 1997	114	8	106

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.

22 Assets transferred under sale and repurchase transactions

	1997 £m	1996 £m
Treasury bills and other eligible bills	1,439	787
Debt securities	1,217	787
	2,656	1,574

23 Interests in associated undertakings

	£m
At 1 January 1997	142
Exchange and other adjustments	10
Additions	9
Disposals	(123)
Transfer to group undertakings	(13)
Retained profits	–
At 31 December 1997	25

	1997 £m	1996 £m
Interests in banks	2	123
Interests in other associated undertakings	23	19
Total – all unlisted	25	142

The Group disposed of its interest in its associate Banco Multiplic SA as part of the consideration for its purchase of 100 per cent of the consumer finance business which trades as Losango (note 47).

During 1997 the Group acquired further shares in its associate Banco Anglo Colombiano SA with the result that its interest increased from 49 per cent to 61 per cent. With effect from 1 October 1997 Banco Anglo Colombiano SA has been accounted for as a group undertaking.

24 Interests in group undertakings

	Company	
	Shares £m	Loans £m
At 1 January 1997	5,591	1,861
Exchange and other adjustments	(4)	–
Additions	2,576	201
Disposals	(926)	–
Repayment of loans	–	(813)
Revaluations	626	–
At 31 December 1997	7,863	1,249

	1997 £m	1996 £m
Banks	4,697	3,774
Other	3,166	1,817
Total – all unlisted	7,863	5,591
On an historical cost basis, shares in group undertakings would have been included as follows:		
Cost	4,987	2,974
Provisions	(19)	(71)
	4,968	2,903

24 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 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 Bank Factors Limited	England	†100%	Credit factoring
Lloyds Leasing Limited	England	†100%	Financial leasing
Lloyds 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
TSB Bank plc	England	†100%	Banking and financial services
TSB Bank Channel Islands Limited	Jersey	†100%	Banking and financial services
TSB Bank Scotland plc	Scotland	†100%	Banking and financial services
TSB Life Limited	England	†100%	Life assurance
TSB General Insurance Limited	England	†100%	General insurance
Hill Samuel Asset Management Group Limited	England	†100%	Investment management
Abbey Life Assurance Company Limited	England	†100%	Life assurance
Lloyds Bank Insurance Services Limited	England	†100%	Insurance broking
Black Horse Financial Services Group Limited	England	†100%	Life assurance and other financial services
Lloyds UDT Limited	England	†100%	Consumer credit, leasing and related services

†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 Bank Plc operates principally in the UK but also through branches in Belgium, Brazil, Dubai, Gibraltar, Guatemala, Hong Kong, Honduras, Isle of Man, Japan, Luxembourg, Malaysia, Monaco, Netherlands, Panama, Paraguay, Switzerland, the Channel Islands and USA and a representative office in Iran.
Lloyds Bank (BLSA) Limited operates in Argentina, Ecuador, Spain and Uruguay.
The National Bank of New Zealand Limited also operates through representative offices in Hong Kong, Japan, the UK and USA.

25 Tangible fixed assets

	Premises £m	Equipment £m
Cost or valuation:		
At 1 January 1997	1,349	2,102
Exchange and other adjustments	(19)	(17)
Adjustments on acquisitions and disposals	19	(4)
Additions	62	202
Disposals	(121)	(136)
Premises revaluation	(144)	–
At 31 December 1997	1,146	2,147
Depreciation:		
At 1 January 1997	171	1,318
Exchange and other adjustments	(8)	(13)
Adjustments on acquisitions and disposals	7	(5)
Charge to restructuring provision	1	2
Charge for the year	41	206
Disposals	(5)	(95)
Premises revaluation	(26)	–
At 31 December 1997	181	1,413
Balance sheet amount at 31 December 1997	965	734
	1,699	
Balance sheet amount at 31 December 1996	1,178	784
	1,962	

Equipment includes assets held under finance leases which at 31 December 1997 amounted to £7 million, net of accumulated depreciation of £208 million (1996: £19 million, net of accumulated depreciation of £194 million).

	1997 £m	1996 £m
Balance sheet amount of premises comprises:		
Freeholds	680	827
Leaseholds 50 years and over unexpired	62	144
Leaseholds less than 50 years unexpired	223	207
	965	1,178
Balance sheet amount of premises comprises:		
Valued in 1997	699	–
Valued in 1995	–	901
At cost	266	277
	965	1,178
On an historical cost basis, premises would have been included as follows:		
Cost	1,303	1,400
Accumulated depreciation	(290)	(258)
	1,013	1,142
Land and buildings occupied for own activities	861	1,093

The valuations included in the balance sheet in 1997 relate to both UK and overseas premises, the majority of which were carried out by the Group's professionally qualified staff who are Corporate Members of the Royal Institution of Chartered Surveyors or, in the case of certain overseas premises, by local management. The remainder were carried out by local valuers, principally Weatherall in Spain. As a result, the net book value of these premises has been written down by £118 million. The shortfall, which is not considered to be permanent, has been debited to the revaluation reserve. The accounting policy for valuations is set out on page 49 in accounting policy i.

26 Lease commitments

Commitments under non-cancellable operating leases were:

	1997 Premises £m	1997 Equipment £m	1996 Premises £m	1996 Equipment £m
Leases on which the commitment is due to expire in:				
1 year or less	3	24	3	24
5 years or less but over 1 year	20	10	27	24
Over 5 years	163	–	161	–
	186	34	191	48

Obligations under finance leases were:

	1997 Equipment £m	1996 Equipment £m
Amounts payable in:		
1 year or less	5	9
5 years or less but over 1 year	7	8
	12	17

27 Capital commitments

Capital expenditure contracted but not provided for at 31 December 1997 amounted to £6 million (1996: £17 million).

28 Own shares

Lloyds TSB Group plc sponsors the TSB Group Employee Trust, a discretionary trust for the benefit of employees and former employees of the Lloyds TSB Group. The Company has lent £45 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 1997, 18 million shares were held by the trustees with a book value of £36 million and a market value of £139 million. (1996: 25 million shares with a book value of £47 million and a market value of £106 million).

In addition, a further 11 million ordinary shares were held by TSB Group Holdings (Jersey) Limited at 31 December 1997 (1996: 20 million shares). These shares, upon 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.

29 Other assets

	1997 £m	1996 £m
Foreign exchange and interest rate contracts	3,603	3,714
Other assets	708	932
	4,311	4,646

30 Prepayments and accrued income

	1997 £m	1996 £m
Interest receivable	856	799
Other debtors and prepayments	1,622	1,575
	2,478	2,374

Included within other debtors and prepayments is £225 million (1996: £202 million) relating to the deferred element of the expenditure incurred under cash gift and discount mortgage schemes. If these incentives had been written off as incurred net interest income would have been £23 million lower in 1997 (1996: £123 million).

31 Long-term assurance business

	1997 £m	1996 £m
The value of long-term assurance business attributable to shareholders included in the consolidated balance sheet comprises:		
Net tangible assets of life companies including surplus	**689**	513
Value of long-term assurance business in force	**1,153**	1,137
	1,842	1,650

The shareholders' interest in long-term assurance business in force has been calculated on the basis of the following principal assumptions:

	%
Risk adjusted discount rate (net of tax)	12.5
Gross return: unit linked	10.2 – 10.5
: non linked	7.5
Expenses inflation	5.0

The assumptions for mortality and morbidity are derived from published tables adjusted for demographic differences of policyholders: those in respect of lapses are in line with the experience of the companies concerned.

Economic assumptions, including those relating to investment returns and inflation, are based on 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. A margin over the long-term risk free rate of return is included within the discount rate to reflect the shareholders' overall risk premium; other margins are not included in the profit recognition method.

Allowance for tax is made using models which reflect the relevant tax regimes affecting different classes of product; no credit is taken in respect of any reduction in taxes deriving from expenses attributable to future new business.

Earnings from business in force represents the earnings from policies written in previous years. It includes both regular premium and single premium products but, in particular, does not anticipate any future premiums in the case of the recurring single premium products.

31 Long-term assurance business (continued)

	1997 £m	1996 £m
The income from life assurance business is:		
Value of long-term assurance business at 31 December	**1,842**	1,650
Value of long-term assurance business at 1 January	**1,650**	1,593
Increase in value of long-term assurance business	**192**	57
Exchange and other adjustments	**22**	1
Dividends accrued	**20**	216
Income after tax from long-term assurance business	**234**	274
Income before tax from long-term assurance business	**328**	403
The long-term assurance assets attributable to policyholders comprise:		
Investments	**21,315**	18,567
Value of long-term assurance business in force	**1,153**	1,137
Premises and equipment	**29**	31
Net current (liabilities) assets	**(609)**	54
	21,888	19,789
Long-term assurance business attributable to shareholders	**(1,842)**	(1,650)
	20,046	18,139
Investments shown above comprise:		
Fixed interest securities	**2,988**	3,414
Stocks, shares and unit trusts	**13,837**	12,473
Investment properties	**933**	632
Other properties	**70**	132
Mortgages and loans	**398**	52
Deposits	**3,089**	1,864
	21,315	18,567

32 Assets and liabilities denominated in foreign currencies

	1997 £m	1996 £m
Assets: denominated in sterling	**104,188**	101,283
: denominated in other currencies	**33,872**	27,945
	138,060	129,228
Liabilities: denominated in sterling	**104,042**	100,424
: denominated in other currencies	**34,018**	28,804
	138,060	129,228

33 Deposits by banks

	1997 £m	1996 £m
Repayable on demand	**3,156**	1,996
Other deposits by banks with agreed maturity dates or periods of notice by residual maturity repayable:		
3 months or less	**10,984**	10,853
1 year or less but over 3 months	**1,893**	1,333
5 years or less but over 1 year	**529**	378
Over 5 years	**9**	–
	16,571	14,560

34 Customer accounts

	1997 £m	1996 £m
Repayable on demand	**59,845**	56,197
Other customer accounts with agreed maturity dates or periods of notice by residual maturity repayable:		
3 months or less	**21,621**	21,538
1 year or less but over 3 months	**2,779**	2,957
5 years or less but over 1 year	**949**	803
Over 5 years	**210**	148
	85,404	81,643

35 Debt securities in issue

	1997 £m	1996 £m
Bonds and medium-term notes by residual maturity repayable:		
1 year or less	**1,062**	245
2 years or less but over 1 year	**242**	212
5 years or less but over 2 years	**171**	320
	1,475	777
Other debt securities by residual maturity repayable:		
3 months or less	**7,924**	8,607
1 year or less but over 3 months	**2,386**	1,732
5 years or less but over 1 year	**240**	110
	10,550	10,449
	12,025	11,226

36 Short-term borrowings

	1997 £m	1996 £m
The short-term borrowings of the Company comprise:		
£200m floating rate notes 1997	–	200
£200m floating rate notes 1998	**200**	–
Floating rate unsecured loan notes 2001	**2**	5
	202	205

The notes are not subordinated and bear interest at rates set periodically in advance based on London Interbank rates. The floating rate unsecured loan notes 2001 are repayable, at the noteholders' option, at six monthly intervals.

37 Other liabilities

	1997 £m	1996 £m
Foreign exchange and interest rate contracts	**4,314**	5,095
Current tax	**797**	470
Dividends	**642**	478
Other liabilities	**2,622**	1,852
	8,375	7,895

38 Accruals and deferred income

	1997 £m	1996 £m
Interest payable	**1,291**	1,227
Other creditors and accruals	**1,973**	1,577
	3,264	2,804

39 Deferred tax

	1997 £m	1996 £m
Short-term timing differences	**(94)**	(74)
Pensions prepayment	**118**	86
Restructuring provision	**(55)**	(81)
Provision for Emerging Markets Debt	**(254)**	(232)
Accelerated depreciation allowances	**861**	717
Advance corporation tax recoverable	**(140)**	(109)
	436	307

	£m
At 1 January 1997	**307**
Exchange and other adjustments	**(31)**
Tax provided: current year	**211**
: prior year adjustment relating to rate change	**(51)**
At 31 December 1997	**436**

	1997 £m	1996 £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 or group undertakings were disposed of at their balance sheet amounts or investments in associated undertakings and trade investments at their valuation. It is expected that the majority of these assets will be retained in the business and that, in view of the substantial number of properties 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.

40 Other provisions for liabilities and charges

	Pension obligations £m	Restructuring provisions £m	Other £m	Total £m
At 1 January 1997	**47**	**396**	**383**	**826**
Exchange and other adjustments	(4)	–	–	(4)
Provisions applied	(1)	(198)	(128)	(327)
Adjustments on acquisitions and disposals	(17)	–	(17)	(34)
Charge to profit and loss account	2	–	174	176
At 31 December 1997	**27**	**198**	**412**	**637**

41 Subordinated liabilities

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
* *Undated loan capital:*				
† Perpetual Subordinated Floating Rate Notes	–	100	–	100
† Primary Capital Undated Floating Rate Notes:				
Series 1 (US$750 million)	456	439	–	–
Series 2 (US$500 million)	304	293	–	–
Series 3 (US$600 million)	364	351	–	–
❖ Subordinated 5.57% Step-up Coupon Notes (¥20 billion)	93	101	–	–
11¾% Perpetual Subordinated Bonds	100	100	–	–
• 8% Undated Subordinated Step-up Notes	198	–	–	–
	1,515	1,384	–	100
Dated loan capital:				
† Guaranteed Floating Rate Notes 1997	–	33	–	–
10¼% Subordinated Bonds 1998	150	150	–	–
† Variable Rate Subordinated Notes 1998	40	80	–	–
† Guaranteed Floating Rate Notes 1998 (US$46 million)	28	54	–	–
11⅜% Subordinated Serial Bonds 1998	20	40	–	–
Subordinated Zero Coupon Bonds 1998 (£135 million)	125	113	125	113
†■ Subordinated Floating Rate Notes 1999	227	226	–	–
† Variable Rate Subordinated Notes 2003	100	100	100	100
‡ Eurocurrency Zero Coupon Bonds 2003 (¥3 billion)	12	12	12	12
† Subordinated Floating Rate Notes 2003	18	18	–	–
§ Subordinated Fixed Rate Bonds 2003 (NZ$200 million)	70	83	–	–
† Subordinated Floating Rate Notes 2004	25	25	–	–
7⅜% Subordinated Bonds 2004	398	398	–	–
†✥ Subordinated Floating Rate Notes 2004	100	100	–	–
† Subordinated Floating Rate Notes 2005	25	25	–	–
† Subordinated Floating Rate Notes 2006	100	99	100	99
8½% Subordinated Bonds 2006	248	248	248	248
✻ 7¾% Subordinated Bonds 2007	298	–	–	–
§ Subordinated Fixed Rate Bonds 2007 (NZ$150 million)	53	62	–	–
‡¶ 10⅝% Guaranteed Subordinated Loan Stock 2008	100	100	–	100
9½% Subordinated Bonds 2009	99	99	–	–
‡¶ 12% Guaranteed Subordinated Bonds 2011	100	100	–	100
9⅛% Subordinated Bonds 2011	148	148	148	148
9⅝% Subordinated Bonds 2023	200	200	–	–
†‡ Subordinated Floating Rate Notes 2063	10	22	86	86
	2,694	2,535	819	1,006
Total subordinated liabilities	4,209	3,919	819	1,106

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 and the Subordinated Floating Rate Notes 2063, on-lent to the Company on a subordinated basis.

✻ Issued during 1997 to finance the general business of the Group.

¶ Liabilities transferred from the Company to a group undertaking during 1997.

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

■ Exchangeable at the election of the Group for Subordinated Floating Rate Notes 2009.

❖ Redeemable at the election of the Group in 2015. In the event that the Notes are not redeemed, 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.

• Redeemable at the election of the Group in 2023. In the event that the Notes are not redeemed, the coupon will be reset to a fixed margin over the then 5 year gilt rate.

Dated subordinated liabilities are repayable as follows:

	Group 1997 £m	Group 1996 £m	Company 1997 £m	Company 1996 £m
1 year or less	373	120	125	–
2 years or less but over 1 year	227	350	–	113
5 years or less but over 2 years	15	237	–	–
Over 5 years	2,079	1,828	694	893
	2,694	2,535	819	1,006

42 Called-up share capital

	1997 £m	1996 £m
Authorised:		
Ordinary shares of 25p each	**1,728**	1,728
Limited voting ordinary shares of 25p each	**20**	20
Limited voting preference shares of £1 each	**300**	300
	2,048	2,048

	Ordinary shares of 25p each £m	Limited voting ordinary shares of 25p each £m	Total £m
Issued and fully paid:			
At 1 January 1997	**1,338**	**20**	**1,358**
Issued instead of cash dividends	**3**	**–**	**3**
Issued under employee share schemes	**8**	**–**	**8**
At 31 December 1997	**1,349**	**20**	**1,369**

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 amending the article limiting holdings of ordinary shares to 15 per cent, 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 1997, options to acquire 216 million Lloyds TSB Group shares were outstanding under senior executives' and savings-related share option schemes at prices ranging from 88p to 757p per share exercisable up to 2007.

43 Reserves

	Group £m	Company £m	Associated undertakings £m
Share premium account:			
At 1 January 1997	**42**	**42**	**–**
Premium arising on issue of shares	**31**	**31**	**–**
Shares issued instead of cash dividends	**(3)**	**(3)**	**–**
At 31 December 1997	**70**	**70**	**–**
Revaluation reserve:			
At 1 January 1997	**(163)**	**2,688**	**–**
Increase in net tangible assets of subsidiary undertakings	**–**	**626**	**–**
Transfer from profit and loss account	**65**	**(419)**	**–**
Premises revaluation deficit	**(118)**	**–**	**–**
At 31 December 1997	**(216)**	**2,895**	**–**
Merger reserve:			
At 1 January 1997 and 31 December 1997	**343**	**–**	**–**

	Group £m	Company £m	Associated undertakings £m
Profit and loss account.			
At 1 January 1997	**3,494**	**1,301**	**85**
Exchange and other adjustments	**(83)**	**–**	**(10)**
Premium on acquisition	**(164)**	**–**	**–**
Goodwill written back on sale of businesses	**33**	**–**	**–**
Disposal of interests in associated undertakings	**–**	**–**	**(72)**
Shares issued instead of cash dividends	**63**	**63**	**–**
Transfer to revaluation reserve	**(65)**	**419**	**–**
Retained profit	**1,410**	**122**	**–**
At 31 December 1997	**4,688**	**1,905**	**3**

43 Reserves (continued)

The Group profit and loss account reserves at 31 December include £767 million (1996: £751 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 the current and previous years amounted to £2,591 million of which £2,506 million has been written off over the last 10 years.

44 Transactions with related parties

At 31 December 1997, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons and with officers included:

	1997 Number of persons	1997 Total £000	1996 Number of persons	1996 Total £000
Loans and credit card transactions:				
Directors and connected persons	**26**	**170**	17	55
Officers	**24**	**2,300**	39	4,565

Details of the principal group undertakings are given in note 24. In accordance with FRS 8, transactions or balances with group entities that have been eliminated on consolidation are not reported.

The Group provides certain banking and financial services to associated undertakings. These are conducted on similar terms to third party transactions and are not material to the Group's results. Details of lending to associated undertakings is set out in note 16.

45 Contingent liabilities and commitments

	1997 £m	1996 £m
Contingent liabilities:		
Acceptances and endorsements	**456**	663
Guarantees	**2,142**	1,762
Other:		
Other items serving as direct credit substitutes	**402**	369
Performance bonds and other transaction-related contingencies	**1,245**	1,360
Other contingent liabilities	**8**	195
	1,655	1,924
	4,253	4,349
Commitments:		
Documentary credits and other short-term trade-related transactions	**229**	310
Forward asset purchases and forward forward deposits placed	**2,031**	1,988
Undrawn note issuing and revolving underwriting facilities	**88**	86
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year maturity	**17,813**	15,670
1 year or over maturity	**4,360**	5,609
Other commitments	**20**	325
	24,541	23,988

46 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 1997	Notional principal amount £m	Fair values Assets £m	Fair values Liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	**137,704**	**2,585**	**2,920**
Currency swaps	**11,563**	**356**	**182**
Options purchased	**2,895**	**23**	**17**
Options written	**2,912**	**16**	**33**
	155,074	**2,980**	**3,152**
Interest rate contracts:			
Interest rate swaps	**472,918**	**3,992**	**4,844**
Forward rate agreements	**240,904**	**197**	**151**
Options purchased	**1,224**	**3**	**–**
Options written	**1,370**	**–**	**6**
Futures	**104,140**	**7**	**1**
	820,556	**4,199**	**5,002**
Equity contracts	**1,360**	**264**	**–**
Effect of netting		**(3,840)**	**(3,840)**
Balances arising from off-balance sheet financial instruments		**3,603**	**4,314**

31 December 1996	Notional principal amount £m	Fair values Assets £m	Fair values Liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	199,057	3,331	3,890
Currency swaps	8,945	295	102
Options purchased	3,093	44	20
Options written	1,954	9	16
	213,049	3,679	4,028
Interest rate contracts:			
Interest rate swaps	390,754	3,959	5,072
Forward rate agreements	235,787	423	379
Options purchased	2,856	5	–
Options written	2,294	2	11
Futures	113,738	–	–
	745,429	4,389	5,462
Equity contracts	402	41	–
Effect of netting		(4,395)	(4,395)
Balances arising from off-balance sheet financial instruments		3,714	5,095

46 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 of non-trading instruments entered into with third parties were as follows:

	1997 Notional principal amount £m	1996 Notional principal amount £m
Exchange rate contracts:		
Spot, forwards and futures	**1,050**	2,539
Currency swaps	**172**	275
Options purchased	**–**	59
Options written	**–**	59
	1,222	2,932
Interest rate contracts:		
Interest rate swaps	**4,725**	6,301
Forward rate agreements	**25**	603
Options purchased	**8**	89
Options written	**5**	100
Futures	**–**	77
	4,763	7,170

In addition the Company held non-trading derivatives with a notional principal amount of £400 million (1996: £400 million).

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

	Under 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
31 December 1997				
Exchange rate contracts:				
Notional principal amount	**148,582**	**7,241**	**473**	**156,296**
Net replacement cost	**1,642**	**252**	**35**	**1,929**
Interest rate contracts:				
Notional principal amount	**508,386**	**296,148**	**20,785**	**825,319**
Net replacement cost	**225**	**920**	**387**	**1,532**
Equity contracts:				
Notional principal amount	**44**	**1,114**	**202**	**1,360**
Net replacement cost	**3**	**230**	**31**	**264**
31 December 1996				
Exchange rate contracts:				
Notional principal amount	207,148	8,188	645	215,981
Net replacement cost	2,218	196	25	2,439
Interest rate contracts:				
Notional principal amount	527,615	218,618	6,366	752,599
Net replacement cost	823	898	109	1,830
Equity contracts:				
Notional principal amount	7	329	66	402
Net replacement cost	–	35	6	41

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.

An analysis of the net replacement cost of instruments entered into with third parties by counterparty type is set out below:

	1997 £m	1996 £m
OECD banks	**3,333**	3,180
Other	**392**	1,130
	3,725	4,310

47 Acquisitions

a) In March 1997 the Group announced that a contract had been signed to acquire the consumer finance business, together with certain other assets, of its Brazilian associate Banco Multiplic SA (BMSA). The Group assumed control of the consumer finance business, which trades as Losango, on 1 April 1997 and its results have been consolidated in full since that date. The premium on acquisition of £161 million has been written off directly to reserves. In consideration, the Group relinquished its investment in BMSA to Multiplic Empreedimentos e Comercio SA, the other principal shareholder, and paid US$81 million in cash.

A summarised profit and loss account for Losango for the period from 1 January 1997 to 31 March 1997 is set out below:

	£m
Net interest income	84
Other income and charges	2
	86
Administrative expenses	(25)
Provisions for bad and doubtful debts	(38)
Profit on ordinary activities before tax	23
Tax	(12)
Profit after tax	11
Profit after tax year ended 31 December 1996	123

All recognised gains and losses are included in the profit and loss account.

The balance sheet of Losango as at 1 April 1997 was as follows:

	Book value at 1 April £m	Fair value adjustments £m	Fair value at acquisition £m
Cash and balances at central banks	11	–	11
Treasury and other eligible bills	11	–	11
Loans and advances to customers	606	(22)	584
Debt securities	4	–	4
Tangible fixed assets	43	(6)	37
Other assets	52	–	52
Deposits by banks	(26)	–	(26)
Debt securities in issue	(571)	–	(571)
Other liabilities	(90)	–	(90)
Net assets acquired	40	(28)	12
Goodwill			161
Consideration			173
Satisfied by:			
Investment in BMSA			123
Cash			49
Related costs of acquisition			1
			173

Fair value adjustments have been made to the carrying value of Losango's fixed assets and loan portfolio. The adjustment to fixed assets has been made to reflect a permanent diminution in the value of properties held. The adjustment to the loan portfolio reflects the provision required to state the loan portfolio at its expected recoverable amount.

47 Acquisitions (continued)

b) During 1997 the Group acquired further shares in its associate, Banco Anglo Colombiano SA, for a consideration of £7 million, with the result that its interest increased from 49 per cent to 61 per cent. The transaction has been accounted for in accordance with acquisition accounting principles and goodwill amounting to £3 million has been written off directly to profit and loss account reserves. With effect from 1 October 1997 Banco Anglo Colombiano SA has been accounted for as a group undertaking. The effect on the results of the Group is not material.

48 Consolidated cash flow statement

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

	1997 £m	1996 £m
Operating profit	2,985	2,456
(Increase) decrease in prepayments and accrued income	(314)	51
Decrease in accruals and deferred income	(467)	(313)
Provisions for bad and doubtful debts	421	327
Net advances written off	(553)	(779)
Restructuring provision	–	75
Restructuring costs incurred	(195)	(84)
General insurance claims	145	120
General insurance claims paid	(114)	(107)
Amounts written off fixed asset investments	3	5
Income from long-term assurance business	(328)	(403)
Transfer from life fund	156	232
Interest on subordinated liabilities (loan capital)	321	294
Interest element of finance lease rental payments	1	2
Depreciation	247	254
Other non-cash movements	(176)	(252)
Net cash flow from trading activities	2,132	1,878
Net increase in loans and advances	(9,260)	(4,475)
Net increase in investments other than investment securities	(4,212)	(28)
Net decrease in other assets	528	3,134
Net increase (decrease) in deposits by banks	3,787	(2,715)
Net increase in customer accounts	4,786	5,140
Net increase in debt securities in issue	490	493
Net increase (decrease) in other liabilities	1,100	(3,056)
Net decrease (increase) in items in course of collection/transmission	22	(96)
Other non-cash movements	(27)	(48)
Net cash (outflow) inflow from operating activities	(654)	227

b Analysis of cash as shown in the balance sheet

	1997 £m	1996 £m
Cash and balances with central banks	881	1,272
Loans and advances to banks repayable on demand	5,277	4,502
	6,158	5,774

The Group is required to maintain balances with the Bank of England which, at 31 December 1997, amounted to £275 million (1996: £175 million).

c Analysis of changes in cash during the year

	1997 £m	1996 £m
At 1 January	5,774	4,501
Net cash inflow before adjustments for the effect of foreign exchange movements	395	1,324
Effect of foreign exchange movements	(11)	(51)
At 31 December	6,158	5,774

d Analysis of changes in financing during the year

	Share capital (including premium and merger reserve) 1997 £m	1996 £m
At 1 January	1,743	1,801
Cash inflow from financing	39	32
Shares issued to the minority shareholders in Lloyds Abbey Life plc	–	987
Premium on acquisition	–	(1,077)
At 31 December	1,782	1,743

48 Consolidated cash flow statement (continued)

d Analysis of changes in financing during the year (continued)

	Subordinated liabilities and finance leases 1997 £m	1996 £m
At 1 January	3,936	3,873
Effect of foreign exchange rate changes	14	(157)
Cash inflow from financing	276	237
Capital repayments	(5)	(17)
At 31 December	4,221	3,936

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

	1997 £m	1996 £m
Cash consideration paid	57	–
Cash acquired	(11)	–
Net cash outflow	46	–

f Acquisition of group undertakings

	1997 £m	1996 £m
Net assets acquired:		
Cash and balances with central banks	11	–
Loans and advances	736	–
Other monetary assets	112	–
Tangible fixed assets	44	–
Deposits by banks, customer accounts and other liabilities	(887)	–
	16	–
Goodwill arising on consolidation	164	–
	180	–
Satisfied by:		
Investment in Banco Multiplic SA	123	–
Cash	57	–
	180	–

g Disposal of group undertakings and businesses

	1997 £m	1996 £m
Net assets disposed of:		
Loans and advances to customers	2,120	–
Deposits from banks	(2,015)	–
Other net assets	144	1
Goodwill written back on disposal	33	79
	282	80
Profit (loss) on sale	154	(77)
Cash consideration received	436	3

Information for shareholders

Analysis of shareholders

at 31 December 1997

Size of shareholding	Shareholders Number	Shareholders %	Number of ordinary shares Millions	Number of ordinary shares %
1 – 99	50,293	4.80	1.7	0.03
100 – 499	549,159	52.44	190.9	3.54
500 – 999	292,328	27.92	180.8	3.35
1,000 – 4,999	115,744	11.05	228.9	4.24
5,000 – 9,999	20,213	1.93	139.7	2.59
10,000 – 49,999	16,207	1.55	301.4	5.58
50,000 – 99,999	1,106	0.11	75.1	1.39
100,000 – 999,999	1,509	0.14	504.4	9.35
1,000,000 and over	574	0.06	3,773.5	69.93
	1,047,133	100.00	5,396.4*	100.00

** Includes 1,038 million shares (19%) registered in the names of some 1 million individuals. 174 million shares (3%) are held by over 51,000 staff and Group pensioners, or on their behalf by the trustees of the staff profit sharing schemes.*

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 0891 771515. These telephone calls are charged at 50p 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 Bank 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 Bank Registrars. Telephone 01903 702321.

The Company also provides an immediate telephone dealing service through Lloyds Bank 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 Bank Stockbrokers. Telephone 0345 888200.

Personal equity plans (PEPs)

You can invest in Lloyds TSB shares through both a General PEP and a Single Company PEP. For details please contact Lloyds Bank PEPs, Freepost, Haywards Heath, West Sussex RH16 3ZA. Telephone 0345 418418.

Substantial shareholdings

At the date of this report the Company had been notified by the Prudential Corporation Group of its interest in 3% of the Company's issued ordinary share capital. The Company has not received notification that any other person holds 3% or more of the issued ordinary share capital.

Lloyds TSB in the community

Information about the Group's involvement in the community, its role in society, and the Lloyds TSB Foundations can be obtained by writing to Public Affairs, Lloyds TSB Group plc, 71 Lombard Street, London EC3P 3BS.

Shareholder enquiries

The Company's share register is maintained by Lloyds Bank Registrars, The Causeway, Worthing, West Sussex BN99 6DA. Telephone 01903 502541. 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 share dividend scheme which enables you to receive new shares instead of cash dividends
- request for full report and accounts

Financial calendar 1998

13 February
Results for 1997 announced

23 February
Ex-dividend date for 1997 final dividend

27 February
Record date for final dividend

15 April
Annual general meeting in Glasgow

1 May
Final dividend paid

31 July
Results for half-year to 30 June 1998 announced

10 August
Ex-dividend date for 1998 interim dividend

14 August
Record date for interim dividend

9 October
Interim dividend paid

Head office

71 Lombard Street
London EC3P 3BS

Registered office

Henry Duncan House
120 George Street
Edinburgh EH2 4LH
Registered in Scotland no 95000

Registrar

Lloyds Bank Registrars
The Causeway
Worthing
West Sussex BN99 6DA