

Scottish Widows

Results 2006



PRESENTATION OF RESULTS

The impact of the implementation of International Financial Reporting Standards (IFRS) in 2005, and in particular the increased use of fair values, has led to greater earnings volatility than was previously the case under UK GAAP. In order to provide a more comparable representation of underlying business performance, this volatility has been separately analysed for the Group's insurance and banking businesses (page 35, note 2). In addition, the profit and loss on the sale and closure of businesses in 2005 has been separately analysed in the Group's results. A reconciliation of this basis of presentation to the statutory profit before tax is shown on page 1. Certain commentaries separately analyse the impact in 2006 of the one-off pension schemes related credit and, in 2005, of customer redress provisions and the strengthening of reserves for annuitant mortality.

For 2006, the Group has introduced supplementary financial reporting relating to Scottish Widows Group using European Embedded Value ('EEV') Principles as published by the Chief Financial Officers Forum in 2004. The Group has also aligned the accounting for insurance products which are recognised on an embedded value basis under IFRS to a basis consistent with relevant EEV Principles.

Unless otherwise stated the analysis throughout this document compares the year ended 31 December 2006 to the year ended 31 December 2005.

FORWARD LOOKING STATEMENTS

This announcement contains forward looking statements with respect to the business, strategy and plans of the Lloyds TSB Group, its current goals and expectations relating to its future financial condition and performance. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. The Group's actual future results may differ materially from the results expressed or implied in these forward looking statements as a result of a variety of factors, including UK domestic and global economic and business conditions, risks concerning borrower credit quality, market related risks such as interest rate risk and exchange rate risk in its banking business and equity risk in its insurance businesses, changing demographic trends, unexpected changes to regulation or regulatory actions, changes in customer preferences, competition and other factors. Please refer to the latest Annual Report on Form 20-F filed with the US Securities and Exchange Commission for a discussion of such factors. The forward looking statements contained in this announcement are made as at the date of this announcement, and the Group undertakes no obligation to update any of its forward looking statements.

INSURANCE AND INVESTMENTS

Excluding volatility	2006	2005	Change
	£m	£m	%
Net interest income	56	79	(29)
Other income	1,740	1,587	10
Total income	1,796	1,666	8
Insurance claims	(200)	(197)	(2)
Total income, net of insurance claims	1,596	1,469	9
Operating expenses	(646)	(607)	(6)
Insurance grossing adjustment (see page 8)	23	18	
Profit before tax, before strengthening of reserves for mortality	973	880	11
Strengthening of reserves for mortality	-	(155)	
Profit before tax	973	725	34
Profit before tax analysis			
Life, pensions and OEICs*	701	655	7
General insurance	243	209	16
Scottish Widows Investment Partnership	29	16	81
Profit before tax*	973	880	11
Present value of new business premiums (PVNBP)	9,740	7,842	24
PVNBP new business margin (EEV basis)	3.6%	3.2%	

*excluding, in 2005, strengthening of reserves for mortality

Key highlights

- **Significantly improved profit performance.** Profit before tax, excluding strengthening of reserves for mortality, increased by 11 per cent to £973 million. On a like-for-like basis, adjusting for the impact of the £800 million capital repatriation in December 2005, profit before tax increased by 15 per cent.
- **Good income growth.** On a similar like-for-like basis, income, net of insurance claims, increased by 12 per cent, exceeding cost growth of 6 per cent.
- **Excellent sales performance.** 24 per cent increase in Scottish Widows' present value of new business premiums.
 - Excellent progress in increasing bancassurance sales, up 62 per cent, with OEIC sales more than doubled.
 - Good momentum maintained in sales through Independent Financial Advisers. Sales increased by 14 per cent, reflecting excellent growth in the sales of corporate pension products.
- **Improved profitability.** Life, pensions and OEICs new business profit in Scottish Widows increased by 36 per cent and the post-tax return on embedded value increased to 9.3 per cent. Good improvement in new business margin, on an EEV basis, to 3.6 per cent.
- **Excellent capital position** of Scottish Widows maintained. Scottish Widows continues to deliver improving capital efficiency and self-financing growth, and a further £540 million of capital was repatriated to the Group in the second half of 2006.
- **Good progress with General Insurance's strategy** to develop its manufacturing business and build distribution capability. Clear focus on improving underwriting, supply chain efficiency and claims management contributed to profit before tax increasing by 16 per cent.

INSURANCE AND INVESTMENTS (continued)

Scottish Widows Life, Pensions and OEICs

Profit before tax increased by £46 million, or 7 per cent, to £701 million. In December 2005, Scottish Widows repatriated £800 million of surplus capital to the Group as part of a capital restructuring programme. This capital repatriation has the effect of reducing investment earnings and increasing funding charges by a total of £38 million in 2006. Adjusting 2005 for this impact, profit before tax increased by 14 per cent.

During 2006 Scottish Widows has made strong progress in each of its key business priorities: to maximise bancassurance success; to profitably grow IFA sales; to improve service and operational efficiency and to optimise capital management.

Maximising bancassurance success

In 2006, Scottish Widows' bancassurance sales increased by 62 per cent, building on the success of the simplified product range for distribution through the Lloyds TSB branch network, Business Banking and Wealth Management channels. Sales of OEICs were particularly strong, more than doubling year on year through the bancassurance channel. Towards the end of 2006, Scottish Widows launched a new protection product platform 'Protection for Life', which is expected to result in an increase in protection sales during 2007. In addition, in early 2007 a new protected OEIC product was launched in the bancassurance market to support sales of savings and investment products.

Profitably growing IFA sales

Sales through the IFA distribution channel increased by 14 per cent, largely reflecting the introduction of improved product and service offerings for corporate pensions which, together with increased promotional activity, resulted in excellent growth in corporate pension sales via the IFA channel, and good levels of post A-Day growth in retirement income products. Scottish Widows has also developed a new pensions platform for launch in early 2007 to support future pre and post retirement sales, and continues to increase its segmental focus on the IFA market to ensure maximum value is obtained from this market.

Improving service and operational efficiency

Operational efficiencies have continued to improve during 2006, and expense growth has been controlled to significantly below the rate of income growth. Scottish Widows' customer satisfaction levels continued to improve, as did levels of IFA satisfaction. Scottish Widows has again won a significant number of awards for service quality.

Optimising capital management

Scottish Widows' strong capital management has been reinforced by continuing to deliver improving capital efficiency and self-financing growth, a more capital efficient product profile, and improved internal rates of return and new business margins. As a result, the post-tax return on embedded value increased to 9.3 per cent, from 8.0 per cent last year. During 2006, surplus capital generated, excluding volatility and non-recurring items, in excess of the regular annual dividend totalled £227 million. £540 million of capital was repatriated to Lloyds TSB in December 2006, giving a total capital repatriation to the Group of over £1.7 billion over the last two years. We continue to explore a number of opportunities to repatriate surplus capital from Scottish Widows, in order to further improve capital efficiency.

INSURANCE AND INVESTMENTS (continued)

Industry practice has historically been to measure new business sales on a weighted Annual Premium Equivalent (APE) basis, where APE is calculated as the value of regular premium sales plus 10 per cent of single premium sales (page 50, note 18). Industry practice is moving towards an alternative basis of calculation - Present Value of New Business Premiums (PVNBP). This is calculated as the value of single premiums plus the discounted present value of future expected regular premiums. An analysis of new business sales on a PVNBP basis can be found in the following table.

Present value of new business premiums (PVNBP)	2006	2005	Change
	£m	£m	%
Life and pensions:			
Savings and investments	1,300	1,465	(11)
Protection	232	255	(9)
Individual pensions	2,219	2,197	1
Corporate and other pensions	1,961	1,517	29
Retirement income	960	658	46
Managed fund business	348	535	(35)
Life and pensions	7,020	6,627	6
OEICs	2,720	1,215	124
Life, pensions and OEICs	9,740	7,842	24
Single premium business	7,321	5,636	30
Regular premium business	2,419	2,206	10
Life, pensions and OEICs	9,740	7,842	24
Bancassurance	3,421	2,114	62
Independent financial advisers	5,358	4,698	14
Direct	613	495	24
Managed fund business	348	535	(35)
Life, pensions and OEICs	9,740	7,842	24
New business margin (PVNBP)	3.6%	3.2%	

Overall, sales in 2006 increased by 24 per cent reflecting, in particular, strong growth in the sales of OEICs and corporate pension products. Bancassurance sales improved significantly and were 62 per cent higher at £3,421 million, including excellent growth in the sales of OEICs through the branch network and to Lloyds TSB private banking clients. IFA sales grew 14 per cent to £5,358 million, supported by significant product and service enhancements in pensions and retirement income. Sales of savings and investment products declined during the year, following the limiting of investment in the Property Fund in June 2006, but this reduction was more than offset by a significant increase in the sale of OEIC and pension products.

INSURANCE AND INVESTMENTS (continued)

Results on a European Embedded Value (EEV) basis

In May 2004, the Chief Financial Officers Forum ('CFO Forum') published its European Embedded Value Principles and Guidance which set out a series of agreed standards for embedded value reporting. These EEV Principles establish a consistent treatment for the financial information provided for insurance and investment contracts and, in our view, allow a fuller recognition of the economic value being created. Compared with traditional embedded value, EEV Principles also provide a more appropriate valuation of in-force business which explicitly takes into account the cost of financial options and guarantees, and required capital, as well as non-market risks, such as mortality.

Lloyds TSB continues to report under IFRS, however, in line with industry best practice, the Group has introduced supplementary financial reporting relating to Scottish Widows on an EEV basis. The following EEV supplementary results have been prepared in accordance with the CFO Forum's EEV Principles and Guidance.

Full details of the Group's adoption of EEV Principles are available on the Group's website at www.investorrelations.lloydstsb.com

INSURANCE AND INVESTMENTS (continued)

	2006			2005			Change %
	Life and Pensions £m	OEICS £m	Total £m	Life and Pensions £m	OEICS £m	Total £m	
New business profit	287	59	346	231	23	254	36
Existing business							
- Expected return	361	42	403	330	31	361	12
- Experience variances	35	34	69	5	7	12	
- Assumption changes	(129)	(4)	(133)	(147)	-	(147)	
	267	72	339	188	38	226	50
Expected return on shareholders' net assets	160	7	167	202	7	209	(20)
Profit before tax, adjusted for capital repatriation*	714	138	852	621	68	689	24
Impact of £800 million capital repatriation to Group	-	-	-	38	-	38	
Profit before tax*	714	138	852	659	68	727	17
New business margin (PVNBP)	4.1%	2.2%	3.6%	3.5%	1.9%	3.2%	
Post-tax return on embedded value*			9.3%			8.0%	

*excluding volatility, other items and, in 2005, the strengthening of reserves for mortality.

Adjusting for the impact of last year's capital repatriation, EEV profit before tax from the Group's life, pensions and OEICs business increased by 24 per cent to £852 million. The Group's strategy to improve its returns by focusing on more profitable, less capital intensive, business whilst constantly seeking to improve process and distribution efficiency has led to a 36 per cent increase in new business profit to £346 million. As a result of improvements in key individual product margins and strong sales of corporate pensions and OEICs the new business margin increased to 3.6 per cent, compared with 3.2 per cent for 2005.

Existing business profit increased by 50 per cent. Expected return has increased by 12 per cent to £403 million reflecting higher earnings on the larger value of in-force business at the start of the year. Positive experience variances were driven by lower than expected take-up rates on guaranteed annuity options in Life and Pensions and by favourable lapse experience in OEICs. These were more than offset by negative assumption changes, primarily in respect of lapse assumptions in Life and Pensions, and resulted in an overall net charge for experience variances and assumption changes, on an EEV basis, of £64 million. The equivalent net charge on an IFRS basis was £7 million. The expected return on shareholders' net assets has decreased, largely as a result of lower assumed rates of return on free assets.

Overall the post-tax return on embedded value increased to 9.3 per cent from 8.0 per cent.

Scottish Widows Investment Partnership

Pre-tax profit from Scottish Widows Investment Partnership (SWIP) increased to £29 million, compared with £16 million in 2005, reflecting increased revenues from higher funds under management throughout the period. SWIP's assets under management increased by 7 per cent to £102 billion, and Groupwide funds under management increased by 4 per cent to £126 billion.