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SCOTTISH WIDOWS ADMINISTRATION SERVICES LIMITED

DIRECTORS' REPORT

AND

FINANCIAL STATEMENTS

31 DECEMBER 2012

Member of Lloyds Banking Group plc

CONTENTS

COMPANY INFORMATION

Board of Directors

A N Davis
R W Fletcher
T E Strauss

Company Secretary

T C Nicholls

Auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Erskine House
68-73 Queen Street
Edinburgh
EH2 4NH

Registered Office

25 Gresham Street
London
EC2V 7HN

Company Number

01132760

DIRECTORS' REPORT

Principal activity and review of the business

The Directors present the audited financial statements of Scottish Widows Administration Services Limited (the "Company"), a limited liability company domiciled and incorporated in the United Kingdom The Company is a wholly owned subsidiary of Scottish Widows plc ("SW")

Since 25 October 2006 the Company has provided outsourcing services in respect of business transferred from Scottish Widows Services Limited ("SWS") as well as providing administration services for a number of other pension contracts

All servicing activities relating to these contracts are carried out using staff and facilities provided by SWS or SW and the costs are recharged to the Company

Capital injection

The Company obtained additional FSA permissions during 2011 to enable it to pursue future business development regarding stock lending activities On 17 February 2012, the Company issued an additional £7 5m of ordinary share capital to its parent, SW in exchange for cash at nominal value (£1 per ordinary share) The investment will be used to meet the capital requirements of the company's new activities

Stock lending

The company has entered into an arrangement to carry out oversight of the securities lending programme for a number of Insurance legal entities which is managed by an external securities lending agent The gross fee is received on a monthly basis from the borrower to the lender, of which five per cent is taken as an arrangement fee to the Company

Results and dividend

The result for the year ended 31 December 2012 is a profit after tax of £1,069,000 (2011 £128,000) and this has been transferred to reserves The Directors consider this result to be satisfactory in light of the activities of the Company during the year as set out above The Directors do not recommend the payment of a dividend for the year (2011 £nil)

Key performance indicators

The Directors are of the opinion that the information presented in the financial statements as a whole provides the management information necessary for the Directors to understand the development, performance and position of the Company

The Company also forms part of LBG The development, performance and position of the Scottish Widows group companies are presented within LBG's financial statements, which do not form part of this report

Future outlook

The Directors consider that the Company's activities will continue unchanged for the foreseeable future

Principal risks and uncertainties

The management of the business and the execution of the Company's strategy are subject to a number of risks The financial risk management objectives and policies of the Company and the exposure to credit, market and financial soundness risk are set out in note 15

Directors

The names of the current Directors are listed on page 3 Changes in directorships during the year and since the end of the year are as follows

P Penney	(resigned 31 August 2012)
N L N Machray	(resigned 31 March 2013)
A N Davis	(appointed 30 December 2012)

Particulars of the Directors' emoluments are given in note 16

All directors have the benefit of a contract of indemnity, which is both a Qualifying Third Party Indemnity Provision and a Qualifying Pension Scheme Indemnity Provision This was in force during the whole of the year Directors no longer in office but who served on the Board at any time in the year had the benefit of this contract of indemnity during that period of service

DIRECTORS' REPORT (CONTINUED)

Disclosure of information to auditors

Each person who is a Director at the date of approval of this report confirms that, so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware and each Director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information This confirmation is given, and should be interpreted in accordance with, the provisions of the Companies Act 2006

Statement of Directors' responsibilities

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations

Company law requires the Directors to prepare financial statements for each financial year Under that law, the Directors have prepared the financial statements in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period In preparing these financial statements, the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and accounting estimates that are reasonable and prudent,
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006 They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

On behalf of the Board of Directors

A N Davis Andrew N Davis
Director
23 April 2013

INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF SCOTTISH WIDOWS ADMINISTRATION SERVICES LIMITED

We have audited the financial statements of Scottish Widows Administration Services Limited for the year ended 31 December 2012 which comprise the statement of comprehensive income, the balance sheet, the statement of cash flows, the statement of changes in equity and the related notes The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union

Respective responsibilities of Directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 5, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the Directors, and the overall presentation of the financial statements

In addition, we read all the financial and non-financial information in the Directors' Report and Financial Statements to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2012 and of its profit and cash flows for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of Directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit

Karyn Lamont

Karyn Lamont (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
23 April 2013

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2012

	Notes	2012 £000	2011 £000
Revenue			
Operating income	2	18,662	6,063
Total revenue		18,662	6,063
Expenses			
Operating expenses	3	(17,272)	(5,917)
Total expenses		(17,272)	(5,917)
Operating profit		1,390	146
Investment income	4	25	29
Profit before tax		1,415	175
Taxation charge	5	(346)	(47)
Profit for the year		1,069	128

There are no items of comprehensive income which have not already been presented in arriving at the profit for the year Accordingly, the profit for the year is the same as total comprehensive income for the year

The notes set out on pages 11 to 23 are an integral part of these financial statements

BALANCE SHEET AS AT 31 DECEMBER 2012

	Notes	2012 £000	2011 £000
ASSETS			
Financial assets			
Trade and other receivables	6	5,058	5,794
Accrued income and prepayment	7	1,255	1,338
Cash and cash equivalents	8	19,501	5,008
Total assets		25,814	12,140
EQUITY AND LIABILITIES			
Capital and reserves attributable to Company's equity holder			
Called up share capital	9	23,500	16,000
Other reserves	10	44,000	44,000
Retained earnings		(54,415)	(55,484)
Total equity		13,085	4,516
Liabilities			
VAT payable		159	176
Current tax payables	11	393	47
Financial liabilities			
Trade and other payables	12	10,922	6,063
Accruals and deferred income	13	1,255	1,338
Total liabilities		12,729	7,624
Total liabilities and shareholder's equity		25,814	12,140

Approved by the Board on 23 April 2013

A N Davis
Director

Andrew N Davis

The notes set out on pages 11 to 23 are an integral part of these financial statements

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2012

	Notes	2012 £000	2011 £000
Cash flows from operating activities			
Profit before tax		1,415	175
Adjusted for			
Investment income	4	(25)	(29)
Net decrease / (increase) in operating assets and liabilities	14	5,578	436
Taxation paid		-	(75)
Net cash flows from operating activities		6,968	507
Cash flows from financing activities			
Proceeds from capital injection		7,500	-
Net cash flows from financing activities		7,500	-
Cash flows from investing activities			
Investment income		25	29
Net cash flows from investing activities		25	29
Net increase / (decrease) in cash and cash equivalents		14,493	536
Cash and cash equivalents at the beginning of the year		5,008	4,472
Cash and cash equivalents at the end of the year	8	19,501	5,008

The notes set out on pages 11 to 23 are an integral part of these financial statements

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2012

	Share capital £000	Retained earnings £000	Other reserves £000	Total £000
Balance as at 1 January 2011	16,000	(55,612)	44,000	4,388
Profit for the year and total comprehensive income	-	128	-	128
Balance as at 31 December 2011	16,000	(55,484)	44,000	4,516
Profit for the year and total comprehensive income	-	1,069	-	1,069
Capital injection	7,500			7,500
Balance as at 31 December 2012	23,500	(54,415)	44,000	13,085

All of the above amounts are attributable to the equity holder of the Company

The notes set out on pages 11 to 23 are an integral part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

1. Accounting policies

(a) Basis of Preparation

The financial statements have been prepared

(1) in accordance with the International Accounting Standards ("IASs") and IFRSs issued by the International Accounting Standards Board and the Standards and Interpretations ("SICs") and International Financial Reporting Interpretations ("IFRICs") issued by its International Financial Reporting Interpretations Committee, as endorsed by the European Union,

(2) in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRSs, and

(3) under the historical cost convention, as modified by the revaluation of certain financial assets as set out in the relevant accounting policies

The Directors are satisfied that the Company has adequate resources to continue in business for the foreseeable future Accordingly, the financial statements of the Company have been prepared on a going concern basis

In accordance with IAS 1 "Presentation of Financial Statements", assets and liabilities in the balance sheet are presented in accordance with management's estimated order of liquidity Analysis of the assets and liabilities of the Company into amounts expected to be received or settled within 12 months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in the notes

Standards and interpretations effective in 2012

A number of standards, amendments to and interpretations of published standards which have the potential to impact on the Company's operations have been issued and are mandatory for accounting periods beginning on or after 1 January 2012 Their relevance to the Company's operations is assessed at note 17

Details of standards and interpretations in issue but which have not been adopted early are set out in note 18

(b) Financial assets and financial liabilities

Management determines the classification of its financial assets and financial liabilities at initial recognition Management's policies for the recognition of specific financial assets and financial liabilities, as identified on the balance sheet, are set out under the relevant accounting policies

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Company has transferred substantially all of the risks and rewards of ownership Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires

All financial assets and financial liabilities are stated at amortised cost, with the exception of the investment in a liquidity fund which is valued at fair value

No assets are classified as held-to-maturity, available-for-sale or for trading, no liabilities are classified as held for trading

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously

(c) Revenue recognition

Operating income

Operating income, which arose wholly in the United Kingdom, consists of service charges in respect of outsourcing services provided to third parties Operating income is recognised in the statement of comprehensive income as these services are provided

Investment income

Interest income for all interest bearing financial instruments is recognised in the statement of comprehensive income as it accrues, within investment income

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONTINUED)

1. Accounting policies (continued)

(d) Expense recognition

Operating expenses

Administration costs are recognised in the statement of comprehensive income as incurred, within operating expenses

(e) Trade and other receivables

Trade and other receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market

Trade and other receivables are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost, subject to impairment In practice, the carrying value of these assets equates to the fair value due to the short-term nature of the amounts included within trade and other receivables

A charge for impairment in respect of trade and other receivables would be made in the statement of comprehensive income when there is objective evidence that the Company will not be able to collect all amounts due according to their original terms The impairment charge would be recognised in that part of the statement of comprehensive income in which the original transaction was reported Further information on the Company's impairment policy is set out at policy (i)

(f) Accrued income and prepayment

The recognition of costs and income is governed by IAS 18 "Revenue" Income received for services to be provided in future periods is deferred and recognised in the statement of comprehensive income as the service is provided Under this standard, directly attributable and incremental costs are capitalised and are then subsequently amortised over the period of the provision of the service

(g) Cash and cash equivalents

Cash and cash equivalents includes cash at bank, short-term highly liquid investments with original maturities of three months or less (excluding such investments as otherwise meet this definition but which are held for investment purposes rather than for the purposes of meeting short-term cash commitments) and bank overdrafts where a legal right of set off exists

(h) Accruals and deferred income

The recognition of costs and income is governed by IAS 18 "Revenue" Income received for services to be provided in future periods is deferred and recognised in the statement of comprehensive income as the service is provided Under this standard, directly attributable and incremental costs are capitalised and are then subsequently amortised over the period of the provision of the service

(i) Impairment

Financial assets

The carrying value of all financial assets held at amortised cost is reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable The identification of impairment and the determination of recoverable amounts is an inherently uncertain process involving various assumptions and factors, including the financial condition of the counterparty, expected future cash flows, observable fair prices and expected net selling prices

In order to determine whether financial assets are impaired, all financial assets for which the fair value has fallen below the recoverable amount (assessed using cost price and the factors above), either by a significant amount or for a prolonged period of time, are individually reviewed A distinction is made between negative revaluations due to general market fluctuations and due to issuer-specific developments The impairment review focuses on issuer-specific developments regarding financial condition and future prospects

Impairment process

Objective evidence that an asset or group of assets is impaired includes observable data that comes to the attention of the Company about the following events

(i) significant financial difficulty of the issuer or debtor,
(ii) a breach of contract,
(iii) the disappearance of an active market for that asset because of financial difficulties, or

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONTINUED)

1. Accounting policies (continued)

(iv) observable data indicating that there is a measurable decrease in the estimated future cashflow from a group of assets since the initial recognition of those assets, even where the decrease cannot yet be identified with the individual assets of the Company, including
- adverse changes in the payment status of issuers or debtors, or
- national or local economic conditions that correlate with defaults on the assets in the Company

The Company first assesses whether objective evidence of impairment exists individually for assets that are individually significant If the Company determines that no objective evidence of impairment exists for an individually assessed asset, whether significant or not, it includes the asset in a group of assets with similar credit risk characteristics and collectively assesses them for impairment Those characteristics are relevant to the estimation of future cashflows for groups of such assets by being indicative of the issuer's ability to pay all amounts due under the contractual terms of the debt instrument being evaluated Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment

(j) Taxes

Tax on the profit or loss for the year is recognised in the statement of comprehensive income and comprises only current tax No provision for deferred tax is required under IAS 12 "Income Taxes" as no timing differences arise which would result in deferred tax on assets and liabilities

Current tax

Current tax is the expected tax payable on the taxable income for the period, using tax rates and legislation enacted or substantively enacted at the reporting date together with adjustments to tax estimates made in prior years

(k) Share capital

Shares are classified as equity when there is no obligation to transfer cash or other assets Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax

(l) Trade and other payables

Trade and other payables are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost In practice, the carrying value of these balances equates to the fair value due to the short-term nature of the amounts included within trade and other payables

2 Operating income

	2012	2011
	£000	£000
Income derived from the oversight of investment management	11,545	-
Pension contract administration	5,819	6,013
Income derived from the oversight of stock lending	1,298	50
Total	18,662	6,063

3. Operating expenses

	2012	2011
	£000	£000
Expenses arising from the oversight of investment management	11,545	-
Administration costs	5,727	5,917
Total	17,272	5,917

(a) The remuneration of the Auditors for the year in respect of audit work is borne by SWS The fees payable in respect of the audit of the statutory accounts of the Company are £5,000 (2011 £5,500) There were no fees relating to non-audit services paid to the Auditors during the year (2011 £nil)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONTINUED)

3. Operatıng expenses (contınued)

(b) The admınıstratıon of the Company ıs undertaken by SWS and SW A recharge ıs levıed from the undertakıng to the Company ın respect of those costs ıncurred on behalf of the Company

Followıng an ımpaırment revıew, admınıstratıon costs ıncludes an ımpaırment charge of £63,000 (2011 £142,000) relatıng to trade receıvables that are past due and ımpaıred (note 6) No amounts ın respect of these ımpaıred contracts wıll be paıd to SWS or SW unless monıes are firstly recovered by the Company A correspondıng reductıon ın trade and other payables (note 12) of £63,000 (2011 £142,000) has therefore, been recognısed ın admınıstratıon costs for the perıod resultıng ın a net charge of zero

(c) The Company had no dırect employees durıng the year (2011 nıl) The employee costs, ıncludıng pensıon costs and share-based payment costs, are ıncluded ın the recharge from SWS noted above

4. Investment ıncome

	2012 £000	2011 £000
Investments at faır value through ıncome		
Interest ıncome on ınvestments ın a lıquıdıty fund	25	29
Total	25	29

5. Taxation

(a) Current year tax charge

	2012 £000	2011 £000
Current tax.		
UK corporatıon tax	346	47
Total current tax	346	47

(b) Reconcılıatıon of tax charge

	2012 £000	2011 £000
Profit before tax	1,415	175
Tax at 24.5% (2011 : 26.5%)	346	47
Total	346	47

The standard rate of Corporatıon Tax ın the UK changed from 26% to 24% wıth effect from 1 Aprıl 2012 Accordıngly, the Company's profits for thıs accountıng perıod are taxed at an effectıve rate of 24 5%

6. Trade and other receivables

	2012 £000	2011 £000
Trade receıvables	819	1,144
Amounts due from related partıes	4,237	4,648
Other loans and receıvables		
Accrued ınterest	2	2
Total	5,058	5,794

All of the above balances are expected to be recovered wıthın one year from the reportıng date

None of the above balances are ınterest-bearıng (2011 none)

Of the above trade debtors balance, £127,000 (2011 £290,000) ıs due ın relatıon to outsourcıng fees on Royal Scottısh Assurance busıness The balance outstandıng at 31 December 2012 was receıved by the Company durıng the current year

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONTINUED)

6. Trade and other receivables (continued)

The trade receivables balance is net of £63,000 (2011 £142,000) of trade debtors in respect of contracts written through SWS and Scottish Widows arrangements that are past due and impaired Recovery of this balance, which relates to various individuals and entities, continues to be pursued by the Company See note 3 for further information

There is no significant concentration of credit risk with respect to the other trade debtors or receivables Further information in respect of credit risk is given in note 15

7. Accrued income and prepayment

	2012 £000	2011 £000
Accrued income	309	289
Prepayments	946	1,049
Total	1,255	1,338

All of the above amounts are expected to be settled within one year after the reporting date

8 Cash and cash equivalents

	2012 £000	2011 £000
Cash at bank	15,382	915
Investments in a liquidity fund	4,119	4,093
Total	19,501	5,008

9 Share capital

	2012 £000	2011 £000
Allotted, called up and fully paid share capital:		
23,500,000 ordinary shares (2011 16,000,000 ordinary shares) of £1 each	23,500	16,000

On 17 February 2012 the company issued a further 7,500,000 ordinary shares in exchange for cash at nominal value (£1 per ordinary share)

10. Other reserves

	2012 £000	2011 £000
Other reserves	44,000	44,000
Total	44,000	44,000

Prior to 2000, when the Company was trading as Lloyds TSB Life Assurance Company Limited, the Company received a capital injection from a related company All assets and liabilities attributable to policyholders and shareholders were transferred to SW at 31 December 2004 when the business was transferred to that company

11. Current tax payable

	2012 £000	2011 £000
Current tax payables	393	47
Total	393	47

£274,000 of the above balance (2011 £47,000) is in respect of group relief for Corporation Tax which is payable to other companies within the LBG

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONTINUED)

12. Trade and other payables

	2012 £000	2011 £000
Amounts due to related parties	10,922	6,063
Total	10,922	6,063

All of the above amounts are expected to be settled within one year after the reporting date

Amounts due to other group companies is net of £63,000 (2011 £142,000) in respect of contracts written through SWS and SW arrangements that are past due and impaired Recovery of this balance, which relates to various individuals and entities, continues to be pursued by the Company

13. Accruals and deferred income

	2012 £000	2011 £000
Accruals	309	289
Deferred income	946	1,049
Total	1,255	1,338

All of the above amounts are expected to be settled within one year after the reporting date

14. Net decrease / (increase) in operating assets and liabilities

	2012 £000	2011 £000
(Increase) / decrease in operating assets:		
Financial assets		
Trade and other receivables	736	(3,802)
Accruals and prepayments	83	285
Net decrease/ (increase) in operating assets	819	(3,517)
Increase in operating liabilities:		
VAT payable	(17)	(10)
Financial liabilities		
Trade and other payables	4,859	4,248
Accruals and deferred income	(83)	(285)
Net increase in operating liabilities	4,759	3,953
Net decrease in operating assets and liabilities	5,578	436

15. Risk management

The Company's principal activity is that of providing outsourcing services in respect of business transferred from SWS

This note summarises the risks associated with the activities of the Company and the way in which these are managed

(a) Governance framework

The Company is part of Lloyds Banking Group ("LBG"), which has established a risk management function with responsibility for implementing the LBG risk management framework within the Scottish Widows Group ("the Group")

Responsibility for the setting and management of risk appetite and risk policy resides with the Board who manage risks in line with LBG and Insurance risk policies The Board has delegated operational implementation to the Insurance Executive Committee

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONTINUED)

15. Risk management (continued)

The approach to risk management ensures that there is effective independent checking or "oversight" of key decisions through the operation of a "three lines of defence" model The first line of defence is line management, who have direct accountability for risk decisions Risk provide oversight and challenge and form the second line of defence Internal Audit constitutes the third line of defence, which provides the required independent assurance to the Audit Committee and the Board that risks within the Company are recognised, monitored and managed within acceptable parameters

An enterprise-wide risk management framework for the identification, assessment, measurement and management of risk is in place The framework is in line with LBG's risk management principles and covers the full spectrum of risks that the Company is exposed to Under this framework, risks are categorised according to an approved LBG risk language which has been adopted across the Company This covers the principal financial risks faced by the Company, including the exposures to market, credit, liquidity, operational and financial soundness risk The performance of the Company, its continuing ability to write business and the strategic management of the business depend on its ability to manage these risks

Policy owners, identified from appropriate areas across the business, are responsible for drafting the LBG and Insurance risk policies, for ensuring that they remain up-to-date and for facilitating any changes These policies are subject to at least an annual review, or earlier if deemed necessary Limits are prescribed within which those responsible for the day to day management of the Company can make decisions Line management are required to follow prescribed reporting procedures to the bodies responsible for monitoring compliance with policy and controlling the risks

(b) Risk appetite

The Board has defined the methodology for the management of risk appetite and has approved appropriate limits

Exposure to each type of risk is monitored against prescribed limits and the results reported to the Board of the Company Where the exposure to any risk exceeds a trigger amount, the Insurance Executive Committee must approve an action plan to reduce the exposure or the Board must approve a revised limit

(c) Financial risks

The Company is exposed to a range of financial risks through its financial assets and financial liabilities The most important components of financial risk are market, credit and financial soundness risk

The Company manages these risks in a number of ways, including risk appetite assessment and monitoring of capital resource requirements

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost The summary of significant accounting policies (note 1) describes how the classes of financial instruments are measured, and how income and expenses are recognised

The sensitivity analysis given in this note in respect of interest rate risk is based on a change in an assumption while holding all other assumptions constant In practice, this is unlikely to occur as changes in an assumption may be correlated The sensitivity analysis presented also represents, in accordance with the requirements of IFRS 7, management's assessment of a reasonably possible alternative in respect of each sensitivity, rather than worst case scenario positions

1) Market risk

Market risk is the risk of reductions in earnings and/or value, through financial or reputational loss, from unfavourable market movements This risk typically arises from fluctuations in market prices, market interest rates (interest rate risk) and foreign exchange rates (foreign exchange risk), whether such changes are caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market

All of the financial assets of the Company which are measured at fair value, which relate to investments in the Global Liquidity Fund ("GLF") of £4,119,000 (2011 £4,093,000), are classified in level 1 of the IFRS 7 fair value hierarchy

Interest rate risk

Interest rate risk is the risk that the value of future cash flows of a financial instrument will fluctuate because of changes in interest rates and the shape of the yield curve Interest rate risk arises in respect of cash balances which are either held on deposit or invested in a cash fund and also in respect of any overdrawn bank balances None of the other financial assets or financial liabilities of the Company are interest-bearing

If interest rates were to increase or decrease by 25 basis points, the impact on profit and loss after tax would be an increase or

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONTINUED)

15. Risk management (continued)

decrease respectively of £36,000 (2011 increase or decrease respectively of £9,000) in respect of interest-bearing financial assets and financial liabilities

The Company is not exposed to price risk or foreign exchange risk through its financial assets and financial liabilities

2) Credit risk

Credit risk is the risk of reductions in earnings and/or value, through financial or reputational loss, as a result of the failure of the party with whom the Company has contracted to meet its obligations

Credit risk is managed in line with the Insurance Credit Risk Policy and the wider LBG Credit Risk Policy

The following table sets out details of those assets which bear credit risk

	2012 £000	2011 £000
Trade and other receivables	5,058	5,794
Accrued income and prepayment	1,255	1,338
Cash and cash equivalents	19,501	5,008
Total assets bearing credit risk	25,814	12,140

The tables below analyse financial assets subject to credit risk using Standard & Poor's rating or equivalent

As at 31 December 2012

	Total £000	AAA £000	AA £000	A £000	BBB or lower	Not rated £000
Trade and other receivables	5,058	2	-	4,237	-	819
Accrued income and prepayment	1,255	-	-	946	-	309
Cash and cash equivalents	19,501	4,119	-	15,382	-	-
Total	25,814	4,121	-	20,565	-	1,128

As at 31 December 2011

	Total £000	AAA £000	AA £000	A £000	BBB or lower	Not rated £000
Trade and other receivables	5,794	-	-	4,766	290	738
Accrued income and prepayment	1,338	-	-	1,049	289	-
Cash and cash equivalents	5,008	4,093	-	915	-	-
Total	12,140	4,093	-	6,730	579	738

Assets classified as "not rated" in the above tables are not rated by Standard and Poor's or an equivalent rating agency Those balances not rated are outstanding balances with customers

Trade and other receivables excludes £63,000 (2011 £142,000) of trade debtors in respect of contracts written through SWS and SW arrangements that are past due and impaired Recovery of this balance, which relates to various individuals and entities, continues to be pursued by the Company

No amounts in respect of these impaired contracts will be paid to SWS or SW unless monies are firstly recovered by the Company A corresponding reduction of £63,000 (2011 £142,000) in operating expenses (note 3) and trade and other payables (note 12) has therefore been reflected in the financial statements

3) Financial soundness risk

Financial soundness risk covers the risk of financial failure, reputational loss or loss of earnings and/or value arising from a lack of liquidity, funding or capital and/or the inappropriate recording, reporting or disclosure of financial, taxation and regulatory information

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONTINUED)

15. Rısk management (continued)

(ı) Financıal, tax, regulatory and dısclosure rısks

LBG ıs exposed to the rısk that polıcıes and procedures are not suffıcıent to maıntaın adequate books and records to support statutory, regulatory and tax reportıng and to prevent and detect fınancıal reportıng fraud

LBG has developed procedures to ensure that complıance wıth both current and potentıal future requırements are understood and that polıcıes are alıgned to ıts rısk appetıte LBG maıntaıns a system of ınternal controls, consıstently applıed, provıdıng reasonable assurance that transactıons are recorded and undertaken ın accordance wıth delegated authorıtıes that permıt the preparatıon and dısclosure of fınancıal statements, regulatory reportıng and tax returns ın accordance wıth IFRSs, statutory and regulatory requırements

LBG undertakes a programme of work desıgned to support an annual assessment of the effectıveness of ınternal controls over fınancıal reportıng, to ıdentıfy tax lıabılıtıes and to assess emergıng legıslatıon and regulatıon

(ıı) Lıquıdıty rısk

Lıquıdıty rısk ıs the rısk that the Company wıll encounter dıffıculty ın raısıng funds to meet ıts fınancıal commıtments as they fall due, or can secure them only at excessıve cost Lıquıdıty rısk may result from eıther the ınabılıty to sell fınancıal assets quıckly at theır faır values, or from the ınabılıty to generate cash ınflows as antıcıpated

Lıquıdıty rısk ıs managed ın lıne wıth the Insurance Lıquıdıty Rısk Polıcy and the wıder LBG Fundıng and Lıquıdıty Rısk Polıcy

Cash and cash equıvalents of £19,501,000 (2011 £5,008,000) have no stated maturıty but can be accessed on demand Trade and other receıvables of £5,058,000 (2011 £5,794,000) are generally recoverable wıthın one month from the reportıng date

Lıquıdıty rısk arısıng ın respect of the Company's fınancıal lıabılıtıes, as requıred by IFRS 7, has been analysed as arısıng from the settlement of trade and other payables of £10,922,000 (2011 £6,063,000) These amounts are all contractually due wıthın one month from the reportıng date

(iii) Capital risk

Capıtal rısk ıs defıned as the rısk that

- the Company has ınsuffıcıent capıtal to provıde a stable resource to absorb all capıtal losses up to a confıdence level defıned ın the rısk appetıte,
- the Company loses reputatıonal status by havıng capıtal that ıs regarded as ınappropriate, eıther ın quantıty, type of dıstrıbutıon, and/or
- the capıtal structure ıs ıneffıcıent

The Company's objectıve when managıng capıtal ıs to have suffıcıent further capıtal to safeguard the Company's abılıty to contınue as a goıng concern so that ıt can contınue to provıde returns for the shareholder and benefıts for other stakeholders

The Company manages the capıtal structure and makes adjustments to reflect changes ın economıc condıtıons and the rısk characterıstıcs of the underlyıng assets In order to maıntaın or adjust the capıtal structure, the Company may return capıtal to the shareholder, ıssue new shares or sell assets

The Company's capıtal comprıses all components of equıty, movements ın whıch are set out ın the statement of changes ın equıty The Company receıves most of ıts fundıng from ıts parent and does not raıse fundıng externally
The table below sets out the regulatory capıtal and the requıred capıtal held at 31 December based on the year end regulatory return

	2012 £000	2011 £000
Regulatory capıtal held	12,016	4,517
Regulatory capıtal requıred	1,479	203

All mınımum regulatory requırements were met durıng the year

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONTINUED)

15. Risk management (continued)

4) Operational risks

Operational risk covers the risk of reductions in earnings and/or value, through financial or reputational loss, from inadequate or failed internal processes and systems, operational inefficiencies, or from people related or external events

There are a number of categories of operational risk

Customer treatment and processes risk

The risk of regulatory censure and/or a reduction in earnings/value, through financial or reputational loss, from inappropriate or poor customer treatment Associated risks include poor product design and development, customer advice, customer service and customer complaint handling Customer process risk includes customer transactions and processing errors due to incorrect capturing of customer information and/or systems failure

Customer treatment and how LBG as a whole manages its customer relationships affects all aspects of the Group's operations and is closely aligned with achievement of LBG's strategic vision to be the best bank for customers There remains a high level of scrutiny regarding the treatment of customers by financial institutions from regulatory bodies, the press and politicians

People risk

The risk of reductions in earnings and/or value through financial or reputational loss arising from ineffectively leading colleagues responsibly and proficiently, managing people resource, supporting and developing colleague talent, or meeting regulatory obligations related to our people

Financial crime and security risk

Financial crime risk covers the risk of reduction in earnings and/or value, through financial or reputational loss, associated with financial crime and failure to comply with related regulatory obligations, these losses may include censure, fines or the cost of litigation This includes risks associated with fraud and bribery, and obligations related to money laundering, sanctions and counter terrorism

Security risk relates to the risk of reductions in earnings and/or value, through financial or reputational loss, resulting from theft of or damage to the Group's assets, the loss, corruption, misuse or theft of the Group's information assets or threats or actual harm to the Group's people This also includes risks relating to terrorist acts, other acts of war, geopolitical, pandemic or other such events

Organisational infrastructure and change risk

Organisational infrastructure risk covers the risk of reductions in earnings and/or value, through financial or reputational loss, resulting from poor internally facing business processes at a Group, divisional or company level Organisational infrastructure in this context embraces the structures, systems and processes that provide direction, control and accountability for the enterprise Change risk comprises the risk of potential loses from change initiatives failing to deliver to requirements, budget or timescale, failing to implement change effectively or failing to realise desired benefits

Supplier management risk

The risk of reductions in earnings and/or value through financial or reputational loss from services with outsourced partners or third party suppliers

IT Systems risk

The risk of reductions in earnings and/or value through financial or reputational loss resulting from the failure to develop, deliver or maintain effective IT solutions

Legal and prudential regulatory risks

Legal and regulatory risk is the risk of reductions in earnings and/or value, through financial or reputational loss, from failing to comply with the applicable laws, regulations or codes applicable

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONTINUED)

16. Related party transactions

Regulators are interested in protecting the rights of the policyholders and ensuring that the Company is satisfactorily managing affairs for the benefit of the policyholders Regulators are also keen to ensure that the Company maintains appropriate solvency levels to meet unforeseen liabilities arising from reasonably foreseeable economic shocks or natural disasters As such, the Company is subject to regulatory requirements which prescribe and impose certain restrictive provisions

(a) Ultimate parent and shareholding

The Company's immediate parent undertaking is Scottish Widows plc, a Company registered in the United Kingdom

The Company's ultimate parent company and ultimate controlling party is LBG, which is also the parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the Company is a member Scottish Widows plc is the parent undertaking of the smallest such group of undertakings Copies of the LBG financial statements in which the Company is consolidated can be obtained from the Group Secretary's Department, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN

(b) Transactions and balances with related parties

Transactions between the Company and other companies in the LBG

The Company has entered into the following transactions with other related parties during the year and holds the following balances with other related parties at the end of the year

	Transactions in the Year		**Outstanding Balance at 31 December**	
	2012 £000	**2011 £000**	**2012 £000**	**2011 £000**
Relationship				
Parent undertaking:				
Intercompany creditor balance	1,282	-	(53)	(2,015)
Other related parties:				
Investment in Global Liquidity Fund	-	-	4,119	4,093
Investment income	(25)	(29)	2	2
Expenses paid	5,727	5,884	-	-
Bank account balance	-	-	15,382	915
Intercompany debtor balance	4,237	-	5,183	4,648
Intercompany creditor balance	(5,226)	-	(10,869)	(4,048)

The above balances are unsecured in nature and are expected to be settled in cash

Transactions between the Company and key management

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company which, for the Company, are the Directors

Transactions between the key management personnel of the Company and parties related to them as defined by IAS 24 are as follows

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONTINUED)

16. Related party transactions (continued)

Key management compensation

The Directors consider that they receive no remuneration for their services to the Company The Directors are also Directors of certain key operating companies within the Lloyds Banking Group, of which the Company is a member The emoluments of the Directors are disclosed in the financial statements of those companies

HM Treasury

In January 2009, HM Treasury became a related party of the Company following its subscription for ordinary shares in LBG, the Company's ultimate parent company, issued under a placing and open offer As at 31 December 2012, HM Treasury held a 39 2 percent (2011 40 0 per cent) interest in LBG's ordinary share capital and, consequently, HM Treasury remained a related party of the Company throughout 2012

There were no material transactions between the Company and HM Treasury during the year (2011 none) that were not made in the ordinary course of business or that are unusual in their nature or conditions In addition, the Company has entered into transactions with HM Treasury on an arm's length basis including, but not exclusively in relation to, the payment of corporation tax, employment tax, and value added tax

Share-based payments

During the year ended 31 December 2012, the Company's ultimate parent company operated share-based payment schemes, all of which are equity settled Further details in respect of these schemes can be found in the financial statements of that company

17. Standards and interpretations effective in 2012

The Group has adopted the following new standards and amendments to standards which became effective for financial years beginning on or after 1 January 2012 Neither of these standards or amendments has had a material impact on these financial statements

(i) Disclosures – Transfers of Financial Assets (Amendments to IFRS 7) Requires disclosure in respect of all transferred financial assets that are not derecognised in their entirety and transferred assets that are derecognised in their entirety but with which there is continuing involvement

Details of those IFRSs pronouncements which will be relevant to the Group but which were not effective at 31 December 2012 and which have not been applied in preparing these financial statements are given in note 18

18. Future accounting developments

The following pronouncements may have a significant effect on the Group's financial statements but are not applicable for the year ending 31 December 2012 and have not been applied in preparing these financial statements Except as disclosed below, the full impact of these accounting changes is being assessed by the Group

Pronouncement	Nature of change	IASB effective date
Amendments to IAS 1 "Presentation of Financial Statements" – 'Presentation of Items of Other Comprehensive Income'	Requires entities to group items presented in other comprehensive income on the basis of whether they are potentially reclassified to profit or loss subsequently	Annual periods beginning on or after 1 July 2012
Amendments to IFRS 7 "Financial Instruments Disclosures" – 'Disclosures-Offsetting Financial Assets and Financial Liabilities'	Requires an entity to disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the entity's balance sheet	Annual periods beginning on or after 1 January 2013

Pronouncement	Nature of change	IASB effective date
IFRS 9 "Financial Instruments"[1,2]	Replace those parts of IAS 39 'Financial Instruments Recognition and Measurement' relating to the classification, measurement and derecognition of financial assets and liabilities IFRS 9 requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instrument, and eliminates the available-for-sale financial asset and held-to-maturity investment categories in IAS 39 The requirements for financial liabilities and derecognition are broadly unchanged from IAS 39	Annual periods beginning on or after 1 January 2015
IFRS 12 "Disclosure of Interests in Other Entities"	Requires an entity to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows	Annual periods beginning on or after 1 January 2013
IFRS 13 "Fair Value Measurement"	Defines fair value, sets out a framework for measuring fair value and requires disclosures about fair value measurements It applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements	Annual periods beginning on or after 1 January 2013
Amendments to IAS 32 "Financial Instruments Presentation" – 'Offsetting Financial Assets and Financial Liabilities'	Inserts application guidance to address inconsistencies identified in applying the offsetting criteria used in the standard Some gross settlement systems may qualify for offsetting where they exhibit certain characteristics akin to net settlement	Annual periods beginning on or after 1 January 2014

[1] At the date of this report, these pronouncements are awaiting EU endorsement
[2] IFRS 9 is the initial stage of the project to replace IAS 39 Future stages are expected to result in amendments to IFRS 9 to deal with changes to the impairment of financial assets measured at amortised cost and hedge accounting, as well as a reconsideration of classification and measurement Until all stage of the replacement project are complete, it is not possible to determine the overall impact on the financial statements of the replacement of IAS 39

19. Post balance sheet events

The proposed further reductions in the rate of corporation tax to 21 per cent by 1 April 2014 are expected to be enacted during 2013