3104670

ST ANDREW'S LIFE ASSURANCE PLC

REPORT OF THE DIRECTORS

AND

FINANCIAL STATEMENTS

31 DECEMBER 2009

Member of Lloyds Banking Group plc

CONTENTS

COMPANY INFORMATION

Board of Directors

A G Kane*
J Van Der Wielen*
T A Leonard*
P D Loney*
M Christophers
A M Peck

Secretary

S Mayer

Actuarial Function Holder

P Turnbull

Auditors

PricewaterhouseCoopers LLP
31 Great George Street
Bristol
BS1 5QD

Registered Office

33 Old Broad Street
London
EC2N 1HZ

Company Registration Number

3104670

** denotes Executive Director*

DIRECTORS' REPORT

Principal activity and review of business

The Directors present the financial statements of St Andrew's Life Assurance Plc ("the Company") The Company is a limited liability company domiciled in the United Kingdom

The principal activity of the Company is the undertaking of ordinary long-term insurance and savings business and associated investment activities in the United Kingdom The Company offers a wide range of life insurance products such as whole life, term life and investment type products through the Lloyds Banking Group network The Company also reinsures business with other Lloyds Banking Group companies and with insurance entities external to the Company

Results and dividend

The result of the Company for the year ended 31 December 2009 is a loss after tax of £109 7m (2008 profit after tax of £340 1m) and this has been transferred to reserves

No dividends were paid during the year (2008 nil)

Key performance indicators

Total insurance premiums received from policyholders were £1,959 6m (2008 £2,281 1m) All of these premiums were recognised in the statement of comprehensive income with no premiums being subject to deposit accounting

Funds under management are approximately £12 6bn (2008 £10 6bn)

The Directors believe that the Company currently has adequate capital resources and will continue to do so in the foreseeable future Further information on the capital position of the Company is given in note 26

The Directors consider that the above key performance indicators are appropriate to the principal activity of the Company In addition, the Directors are of the opinion that the Financial Services Authority's (FSA) returns capital resource requirement and regular actuarial reports, in conjunction with the information presented in the financial statements as a whole, provide the management information necessary for the Directors to understand the development, performance and position of the business of the Company

The Company also forms part of the Insurance Division of Lloyds Banking Group plc The development, performance and position of this Division are discussed in the Group's annual report, which does not form part of this report

Future outlook

The Directors consider that the Company's activities will continue unchanged in 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 market, insurance, credit and financial soundness risk are set out in note 26

In addition, the Company is also exposed to financial and prudential regulatory reporting risk, in particular the risk of reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over financial reporting or over prudential regulatory reporting and financial reporting fraud The financial and risk management objectives and policies of the Company in respect of financial and regulatory risk are also set out in note 26

The company, like other insurers, is subject to legal proceedings in the normal course of business Whilst it is not practicable to forecast or determine the final results of all pending or threatened legal proceedings, management does not believe that such proceedings, including litigation, will have a material effect on the results and financial position of the Company

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

A G Kane	(appointed 4 March 2009)
J Van Der Wielen	(appointed 4 March 2009)
J Dawson	(resigned 26 March 2009)
S Colsell	(resigned 26 March 2009)
R Devey	(resigned 26 March 2009)
P Gale	(resigned 31 December 2009)
B Duffin	(resigned 18 March 2010)
P D Loney	(appointed 25 March 2010)

Particulars of the Directors' emoluments are set out in note 27

One of the Directors has entered into an individual contract of indemnity with Lloyds Banking Group plc which constitutes a "qualifying third party indemnity provision" and a "qualifying pension scheme indemnity provision" for the purposes of the Companies Act 2006 This contract was in force during the whole of the financial year The contract remains in force and is available for inspection at the registered office of Lloyds Banking Group plc, details of which are given in note 27

Disclosure of information to auditors

Each Director confirms that as far as they are aware there is no relevant audit information of which the Company's auditors are unaware Relevant information is defined as "information needed by the Company's auditors in connection with preparing their report"

Each Director has taken all the steps that he ought to have taken in his duty 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 section 418 of the Companies Act 2006

Change of auditors

Following the resignation of KPMG on 30 April 2009, PricewaterhouseCoopers LLP were appointed as auditors of the Company with effect from the same date by resolution of the members dated 22 June 2009

Pursuant to section 487 of the Companies Act 2006, auditors duly appointed by the members of the Company shall, subject to any resolution to the contrary, be deemed to be reappointed for the next financial year and PricewaterhouseCoopers LLP will therefore continue in office

Policy and practice on payment of creditors

The Company follows "The Better Payment Practice Code" published by the Department for Business Innovation and Skills ("BIS"), regarding the making of payments to suppliers A copy of the code and information about it may be obtained from the BIS, No1 Victoria Street, London, SW1H 0ET

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

The processing of invoices from suppliers and settlement of trade creditors is undertaken by a separate company within the Lloyds Banking Group The number of days shown in this report, to comply with the provisions of the Companies Act 2006, is 20 days (2008 19 days)

On behalf of the Board of Directors

S Mayer
Edinburgh
25 March 2010

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 elected to prepare 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 judgements 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,
- 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

INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF ST ANDREWS LIFE ASSURANCE PLC

We have audited the Company financial statements of St Andrews Life Assurance plc for the year ended 31 December 2009 which comprise the Statement of Comprehensive Income, the Balance Sheet, the Statement of Cash Flow, 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 6, 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 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 member 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 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

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 2009 and of its loss 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 of the information and explanations we require for our audit

Clare Thompson (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Bristol

25 March 2010

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2009

	Note	2009 £ m	2008 (Restated) £ m
Revenue			
Gross premiums earned		1,959 6	2,281 1
Premiums ceded to reinsurers		(8 4)	20 6
Premiums earned net of reinsurance		1,951 2	2,301 7
Fee and commission income	3	2 5	8 1
Investment income	4	441 7	512 3
Net realised losses on assets and liabilities at fair value though income	5	(101 1)	(231 2)
Net fair value gains/(losses) on assets and liabilities at fair value through income	6	1,265 5	(1,969 0)
Total revenue		3,559 8	621 9
Expenses			
Gross claims and benefits		1,379 6	2,078 7
Claims recoveries from reinsurers		(23 5)	(72 4)
		1,356 1	2,006 3
Change in insurance contract liabilities		1,969 4	(1,273 7)
Change in investment contract liabilities		0 3	(529 7)
Change in reinsurers' share of liabilities		2 1	158 7
		1,971 8	(1,644 7)
Operating expenses	7	164 4	195 3
Expenses for asset management services received		34 5	38 8
Finance costs	9	2 6	4 8
		201 5	238 9
Total expenses		3,529 4	600 5
Profit before tax		30 4	21 4
Taxation (charge)/credit	10	(140 1)	318 7
(Loss)/profit for the year		(109 7)	340 1
Other comprehensive income			
Currency translation differences, net of tax		(0 1)	-
Other comprehensive income		**(0 1)**	-
Total comprehensive income		**(109 8)**	**340.1**

The notes set out on pages 12 to 54 are an integral part of these financial statements

The 2008 comparatives have been restated as explained in note 31

BALANCE SHEET AS AT 31 DECEMBER 2009

	Note	2009 £ m	2008 (Restated) £ m	1 Jan 2008 (Restated) £ m
ASSETS				
Deferred costs	11	274 8	275 9	284 2
Deferred tax assets	12	265 7	435 8	122 3
Investment properties	13	88 1	106 1	129 5
Reinsurers' share of insurance contract liabilities	19	98 0	100 1	258 8
Current tax receivable	12	16 6	19 0	-
Financial assets				
Derivative financial instruments	14	173 1	198 8	68 8
Loans and receivables	15	42 9	85 6	150 8
Investments at fair value through income	16	13,083 2	10,953 7	14,402 1
Cash and cash equivalents	17	57 2	105 1	85 8
Total assets		14,099 6	12,280 1	15,502 3
EQUITY AND LIABILITIES				
Capital and reserves attributable to Company's equity shareholder				
Share capital	18	360 0	360 0	360 0
Retained earnings		- 469 1	578 9	238 8
Total equity		829 1	938 9	598 8
Liabilities				
Insurance contract liabilities	19	12,690 7	10,721 3	11,995 0
Deferred tax liabilities	12	156 5	204 1	218 5
Current tax payables	12	31 3	24 4	19 7
Provisions for other liabilities and charges	20	2 1	-	-
Accruals and deferred income	21	-	4 1	4 6
Financial liabilities				
Investment contract liabilities	22	8 7	9 9	2,447 6
Derivative financial instruments	14	20 1	58 7	3 8
Other liabilities	23	361 1	318 7	214 3
Total liabilities		13,270 5	11,341 2	14,903 5
Total liabilities and equity		14,099 6	12,280 1	15,502 3

The notes set out on pages 12 to 54 are an integral part of these financial statements

The 2008 comparatives have been restated as explained in note 31

Approved by the Board on 25 March 2010

T A Leonard
Director

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2009

	Note	2009 £ m	2008 £ m
Cash flows from operatıng actıvıtıes			
Profit before tax		30 4	21 4
Adjusted for			
Movement ın Deferred Costs	11	1 1	8 3
Fınance costs		2 6	4 8
Net (ıncrease)/decrease ın operatıng assets and lıabılıtıes	24	(71 0)	13 1
Taxatıon paıd		(8 3)	(23 5)
Other Comprehensıve ıncome		(0 1)	-
Net cash flows from operatıng actıvıtıes		(45 3)	24 1
Cash flows from financıng actıvıtıes			
Fınance costs paıd	9	(2 6)	(4 8)
Net cash flows from financıng actıvıtıes		(2 6)	(4 8)
Net (decrease)/ıncrease ın cash and cash equıvalents		(47 9)	19 3
Cash and cash equıvalents at the begınnıng of the year		105 1	85 8
Net cash and cash equıvalents at the end of the year	17	57 2	105 1

The notes set out on pages 12 to 54 are an ıntegral part of these financıal statements

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2009

	Issued share capital £ m	Retained earnings £ m	Total £ m
Balance as at 1 January 2008	360 0	238 8	598 8
Total comprehensive income for the year	-	340 1	340 1
Balance as at 31 December 2008	360 0	578 9	938 9
Total comprehensive income for the year	-	(109 8)	(109 8)
Balance as at 31 December 2009	360 0	469 1	829 1

Not all of the above amounts can be distributed to the equity shareholder since the Company is required to meet regulatory capital requireme
Further details are given in note 26

The notes set out on pages 12 to 54 are an integral part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

1 Accounting policies

Summary of significant accounting policies

The Company has identified the accounting policies that are most significant to its business operations and the understanding of its results

The financial statements 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 preparation of the financial statements necessitates the use of estimates and assumptions in applying the accounting policies set out on pages 12 to 21 The accounting policies which relate to insurance contracts (policy p), the ascertainment of fair values of financial assets and financial liabilities (policy c) and the determination of impairment losses (policy m) are those which involve the most complex or subjective decisions or assessments These estimates and assumptions affect the reported amounts of assets and liabilities, contingent or otherwise, at the reporting date, as well as affecting the reported income and expenses for the year

In each case, the determination of these is fundamental to the financial results and position of the Company, and requires management to make complex judgments based on information and financial data that may change in future periods Although the estimates are based on management's best knowledge of current facts as at the reporting date, the actual outcome may differ from those estimates

The significant accounting policies adopted in the preparation of the financial statements, which have been consistently applied to all periods presented in these financial statements, are set out below

(a) Basis of preparation

The financial statements of the Company have been prepared

(1) in accordance with the International Accounting Standards ('IASs") and International Financial Reporting Standards ("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,

(3) under the historical cost convention, as modified by the revaluation of investment properties and certain financial assets and financial liabilities at fair value through income, 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 2009

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 2009 Their relevance to the Company's operations is assessed at note 29

Details of standards and interpretations in issue but which have not been adopted early are set out at note 30

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

1. **Accounting policies (continued)**

(b) Product classification

The Company issues contracts that transfer insurance risk or financial risk or both

Insurance contracts

Insurance contracts are those contracts which transfer significant insurance risk Such contracts may also transfer financial risk As a general guideline, the Company defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event which are significantly more than the benefits payable if the insured event were not to occur Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly over time

Investment contracts

Any long term contracts not considered to be insurance contracts under IFRS because they do not transfer significant insurance risk are classified as investment contracts The Company does not have any investment contracts with a discretionary participation feature ("DPF") Investment contracts without DPF are contracts that neither transfer significant insurance risk nor contain a DPF

(c) Financial assets and financial liabilities

Management determines the classification of its financial assets and financial liabilities at initial recognition and re-evaluates this at every reporting date 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 cashflows 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 designated at fair value through income, with the exception of certain loans and receivables (policy (j)), other financial liabilities (policy (t)) which are stated at amortised cost, and derivatives, as described further in policy (i) The classification depends on the purpose for which the financial assets and financial liabilities were acquired Certain financial assets and financial liabilities, whose default accounting treatment would be to record these balances at amortised cost, are instead designated at fair value through income as they are held to match insurance and investment contract liabilities linked to the changes in fair value of these assets and liabilities, thereby reducing measurement inconsistencies, and the fact that these are managed and their performance evaluated on a fair value basis Information on these balances is provided internally on a fair value basis to the Company's key management The Company's investment strategy is to invest in equity and debt securities investment property and cash and to evaluate the Company's investments with reference to their fair values

Fair value methodology

The Company has adopted the amended IFRS 7 "Financial Instruments Disclosures" from 1 January 2009

Further information on the impact on the Company of the adoption of this amendment is set out in note 29

All financial instruments carried at fair value are categorised into a fair value hierarchy as follows

(i) Level 1

Quoted prices (unadjusted) in active markets for identical assets and liabilities to those being valued An active market is one in which arm's length transactions in the instrument occur with both sufficient frequency and volume to provide pricing information on an ongoing basis Examples include listed equities, listed debt securities, quoted unit trusts traded in active markets and exchange traded derivatives such as futures.

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

1 Accounting policies (continued)

(ii) Level 2

Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices) If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability Level 2 inputs include the following

- Quoted prices for similar (but not identical) instruments in active markets,
- Quoted prices for identical or similar instruments in markets that are not active, where prices are not current, or price quotations vary substantially either over time or among market makers,
- Inputs other than quoted prices that are observable for the instrument (for example, interest rates and yield curves observable at commonly quoted intervals and default rates),
- Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means

Examples of these are securities measured using discounted cash flow models based on market observable swap yields, investment property measured using market observable information, and listed debt or equity securities in a market that is inactive

(iii) Level 3

Inputs for the asset or liability are not based on observable market data (unobservable inputs) Unobservable inputs may have been used to measure fair value where observable inputs are not available This approach allows for situations in which there is little, if any, market activity for the asset or liability at the measurement date (or market information for the inputs to any valuation models) Unobservable inputs reflect the assumptions the Company considers that market participants would use in pricing the asset or liability, for example certain private equity investments held by the Company

Where estimates are used, these are based on a combination of independent third-party evidence and internally developed models, calibrated to market observable data where possible Whilst such valuations are sensitive to estimates, it is believed that changing one or more of the assumptions to reasonably possible alternative assumptions would not change the fair value significantly

Further analysis of the Company's instruments held at fair value is set out at note 16

The Company's management, through a pricing and disclosure committee, review information on the fair value of the Company's financial assets and financial liabilities and the sensitivities to these values on a regular basis

No assets are classified as held-to-maturity or available-for-sale Derivative assets are classified as held for trading With the exception of derivative liabilities, no liabilities are classified as held for trading Further information on derivatives is set out at policy (i)

Transaction costs incidental to the acquisition of a financial asset are expensed through the statement of comprehensive income, within net realised gains and losses on assets and liabilities at fair value through income

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

(d) Revenue recognition

Premium income

Premiums received in respect of life insurance contracts are recognised as revenue when they become payable by the policyholder and are shown before deduction of commission Premiums ceded to reinsurers are recognised when the related gross premiums are recognised Gross and ceded premiums are recorded through the relevant lines in the statement of comprehensive income

Fee and commission income

The Company receives investment management fees in the form of an initial adjustment, or charge, to the amount invested These fees are in respect of services rendered in conjunction with the issue and management of investment contracts where the Company actively manages the consideration received from its customers to fund a return that is based on the investment profile that the customer selected on origination of the contract These services comprise an indeterminate number of acts over the lives of the individual contracts and, therefore, the Company defers these fees and recognises them on a straight-line

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

1 Accounting policies (continued)

basis over the estimated lives of the contracts unless there is evidence to support an alternative recognition basis The income is recognised through the statement of comprehensive income, within fee and commission income The liability is recognised in the balance sheet within accruals and deferred income until recognition criteria are met

Investment income

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

Dividends receivable in respect of listed shares or Open Ended Investment Company ("OEIC") distributions are recognised on the date that these are quoted ex-dividend, other dividend income is recognised when received All dividends received are recognised through the statement of comprehensive income, within investment income

Rental income in respect of investment properties is recognised in the statement of comprehensive income, within investment income, when the right to receive payment is established

(e) Expense recognition

Claims

Claims are recorded as an expense on the earlier of the maturity date or the date on which the claim is notified Claims recoveries from reinsurers are recognised when the related claims are recognised Claims and claims recoveries are recognised through the relevant lines in the statement of comprehensive income

Operating expenses

Commission paid in respect of the business written by the Company is recognised through the statement of comprehensive income, within operating expenses Where certain criteria are met, commission and other acquisition costs may be deferred The circumstances under which such costs are deferred are set out at policy (f)

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

Expenses for asset management services received

Expenses for asset management services received are recognised in the statement of comprehensive income as they accrue, within expenses for asset management services received

Finance costs

Interest expense for all interest-bearing financial instruments is recognised in the statement of comprehensive income as it accrues, within finance costs Finance costs also include interest paid on the late payment of claims This is recognised when incurred

Dividends payable

Dividends payable on ordinary shares are recognised in equity in the period in which they are approved

(f) Deferred costs

Deferred acquisition costs

The costs of acquiring new insurance contracts which are incurred during a financial period but which relate to subsequent financial periods are deferred to the extent that they are recoverable out of future revenue margins The deferred acquisition cost asset is amortised over the lifetime of the related contracts based on the pattern of margins arising from these contracts At each reporting date the asset is reviewed and is impaired where it is no longer expected to be recoverable out of future margins on the related insurance contracts The change in the value of deferred acquisition costs for the year is recognised through the statement of comprehensive income, within operating expenses

1. Accounting policies (continued)

(g) Investment properties

Investment properties, which are held either to earn rental income or for capital appreciation or both are initially measured at fair value This represents the fair value of the consideration given, including directly attributable transaction costs Subsequently, on a quarterly basis and at each reporting date, such properties are carried at fair value as assessed by qualified external appraisers Fair value is based on active market prices, adjusted if necessary for any difference in the nature, location or condition of the specific asset If this information is not available, alternative valuation methods such as discounted cash flow analysis or recent prices in less active markets are used Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value

Gains or losses arising from changes in the fair values of investment properties are recognised in the statement of comprehensive income in the period in which they arise, within net gains and losses on assets and liabilities at fair value through income

(h) Reinsurance assets

The Company cedes reinsurance in the normal course of business Reinsurance assets, which are measured on a basis consistent with the related insurance contract liabilities, include balances due from both insurance and reinsurance companies for ceded insurance liabilities Premiums ceded and claims reimbursed are disclosed separately on the face of the statement of comprehensive income The benefits to which the Company is entitled under its reinsurance contracts held are recognised as reinsurance assets These assets consist of short-term balances due from reinsurers (recognised within loans and receivables), as well as longer term receivables that are dependent on the expected claims benefits arising under the related reinsured insurance contracts (recognised within reinsurers' share of insurance contract liabilities)

The change in reinsurers' share of liabilities on the face of the statement of comprehensive income represents the movement during the year in all amounts recoverable from reinsurers (including those recognised within other loans and receivables, since these amounts are recoverable from third parties under contracts of reinsurance)

(i) Derivative financial instruments

Classification

Derivative financial instruments are held for trading Derivatives held for trading are used for the purposes of efficient portfolio management or to match contractual liabilities

Recognition

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value

Measurement

The best evidence of the fair value of a derivative at initial recognition is the transaction price unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument

Fair values are obtained from quoted market prices in active markets, including recent market transactions For over-the-counter ('OTC') derivatives, the fund manager valuation is used

Data from a primary source will initially be used in valuing derivatives However, tolerance checks are also performed between valuations derived from different sources in order to validate the calculated valuations, detect any potential discrepancies and, if appropriate, select a secondary or tertiary price for use in the valuation instead If, as a result of this process, a value other than one obtained from a primary valuation source were to be used to value a derivative, this would be approved by the Derivatives and Counterparty Risk Committee

For exchange traded contracts, the value is based on the quoted bid price at close of business

Changes in the fair value of derivatives are recognised in the statement of comprehensive income, through net fair value gains and losses on assets at fair value through income
All derivatives are presented as assets when their fair value is positive and as liabilities when their fair value is negative

(j) Loans and receivables

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

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

1 Accounting policies (continued)

Loans and receivables are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost, subject to impairment, with the exception of accrued interest, rent receivable and amounts recoverable from reinsurers which do not meet the definition of reinsurance contracts (as set out in policy (h)), which are accounted for at fair value, reflecting the amounts receivable at the year end In practice, the carrying value of these balances equates to the fair value due to the short-term nature of the amounts included within loans and receivables

A charge for impairment in respect of loans and 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 Receivables arising from insurance contracts are also classified in this category and are reviewed for impairment as part of the impairment review of loans and receivables Such amounts are reflected through the statement of comprehensive income within gross premiums written and claims recoveries from reinsurers Further information on the Company's impairment policy is set out at policy (m)

(k) Investments at fair value through income

Investments at fair value through income comprise debt and equity securities

Classification

A financial asset is classified in this category at inception if acquired principally for the purpose of selling in the short-term, if it forms part of a portfolio of financial assets in which there is evidence of short-term profit-taking, or if designated as such

Recognition

Purchases and sales of financial assets are recognised on the trade date, i e the date the Company commits to purchase the asset from, or deliver the asset to, the counterparty Investments are initially recognised at fair value through income, being the fair value of the consideration given, and are subsequently remeasured at fair value

Measurement

Quoted Investments

The fair values of quoted investments are based on current bid prices If the market for a financial asset is not active, and also for unlisted securities, the Company establishes fair value by using valuation techniques These include the use of arm's length transactions and reference to other instruments that are substantially the same, making maximum use of market inputs and relying as little as possible on entity-specific inputs The following paragraphs detail the valuation techniques specific to equity, Open Ended Investment Companies ("OEIC"s) and debt securities

For equity investments that are quoted and actively traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices at the close of business on the reporting date Prices are provided by vendors such as Reuters or Bloomberg or by direct reference to the Stock Exchange

For quoted debt security investments, bid prices on the reporting date are obtained from index providers who obtain prices from a number of leading brokers, investment banks and market makers Where no independent price is available, a valuation technique is used to determine fair value The technique uses a spread over a comparable term gilt as the best estimate of fair value Spreads are calculated by reference to the wider market movement in credit spreads, the way in which the security is structured, other assets issued by the issuer or other assets with similar characteristics

For corporate bonds, the Company's management perform a comparison of information received from the index provider used against other available price sources on a monthly basis to ensure that prices can be supported by market data

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

1 Accounting policies (continued)

In addition to the measurement policies, investment asset prices are reviewed weekly to identify those assets where the price has not moved for at least six days This review provides an initial indication that the market for each identified asset may be inactive These assets are then reviewed by management who may identify an alternative price source for assets which in their view are still actively traded On conclusion that a particular asset is illiquid, management will identify an alternative valuation technique by deciding whether an appropriate price can be obtained from a recognised independent broker Where this is the case, the broker will be approved as a price source for the asset A price will then be obtained from the broker on a monthly basis A review of all illiquid assets and prices obtained or calculated is conducted by an internal pricing committee on a monthly basis

Unquoted Investments

The fair value of holdings in OEICs and Unit Trusts is determined as the last published price applicable to the OEIC sub-fund or the Unit Trust at the reporting date These are classified as unquoted equity investments

In order to ensure that a fair value is recognised for unquoted or illiquid debt securities, the primary price source is an external broker valuation If available, a further external broker valuation is sought as a secondary valuation source in order to validate the primary source A formal review is then carried out which challenges the external valuation and includes consideration of the impact of any relevant movements in underlying variables such as

- underlying movements in the relevant markets, for example credit spreads,
- how current transactions are being priced in the market,
- how the security is structured, and
- any supporting quantitative analysis as appropriate, for example with reference to Bloomberg or internal models

Net realised gains and losses on assets and liabilities at fair value through income

Realised gains and losses on assets and liabilities are calculated as the difference between net sale proceeds and the original cost and are recognised in the statement of comprehensive income in the period in which they arise, within net realised gains and losses on assets and liabilities at fair value through income

Net fair value gains and losses on assets and liabilities at fair value through income

Unrealised gains and losses on assets and liabilities are calculated as the difference between the current valuation of the asset or liability at the reporting date and the original cost Movements in unrealised gains and losses arising are recognised in the statement of comprehensive income in the period in which they arise, within net fair value gains and losses on assets and liabilities at fair value through income The movement in the unrealised gains and losses recognised in the year also includes the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of asset disposals and liability discharges in the current period

(l) 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

(m) Impairment

Financial assets

The carrying value of all financial assets 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

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

1 Accounting policies (continued)

In order to determine whether financial assets are impaired, all financial assets for which the fair value has fallen below cost price 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, taking into account the intent and ability to hold the securities under the Company's long term investment strategy

Non-financial assets

Assets that have an indefinite useful life, for example land, are not subject to amortisation and are tested annually for impairment Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its estimated recoverable amount The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows

If there is objective evidence that an impairment loss has occurred, the amount of the loss is charged to the relevant line in the statement of comprehensive income in the period in which it occurs

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
(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

(n) Taxes

Tax on the profit or loss for the year is recognised in the statement of comprehensive income within taxation and comprises current and deferred tax

Current tax

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

Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that, at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date

1 Accounting policies (continued)

Deferred income tax assets are only recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences, carry-forward of unused tax assets and unused tax losses can be utilised

The carrying amount of deferred income tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the deferred income tax asset to be utilised

Allocation of tax charge between equity shareholder and policyholders

The tax expense in the statement of comprehensive income is analysed between policyholder and shareholder tax This allocation is based on an assessment of the rates of tax which will be applied to the returns under current UK tax rules

(o) 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

(p) Insurance contracts

The Company issues life insurance contracts to protect customers from the consequences of events (such as death, critical illness or disability) that would affect the ability of the customer or their dependants to maintain their current level of income and also annuity contracts Guaranteed claims paid on occurrence of the specified insured event are either fixed or linked to the extent of the economic loss suffered by the policyholder

Insurance contracts which are not unit-linked

The liability is calculated by estimating the future cash flows over the duration of in-force policies and discounting them back to the valuation date, allowing for probabilities of occurrence The liability will vary with movements in interest rates and with the cost of life assurance and annuity benefits where future mortality is uncertain Assumptions are made in respect of all material factors affecting future cash flows including future interest rates, mortality and costs Changes in the value of these liabilities are recognised in the statement of comprehensive income through changes in insurance contract liabilities

Insurance contracts which are unit-linked

Allocated premiums in respect of unit-linked insurance contracts are recognised as liabilities These liabilities are increased or reduced by the change in the unit prices and are reduced by policy administration fees, mortality and surrender charges and any withdrawals The mortality charges deducted in each period from the policyholders as a group are considered adequate to cover the expected total death benefit claims in excess of the contract account balances in each period and hence no additional liability is established for these claims Revenue consists of fees deducted for mortality, policy administration and surrender charges Interest or changes in the unit prices credited to the account balances incurred in the period are charged as expenses in the statement of comprehensive income, through changes in insurance contract liabilities as appropriate Benefit claims in excess of the account balances incurred in the period are charged as expenses in the statement of comprehensive income, through gross claims and benefits paid

Receivables and payables

Receivables and payables are recognised when due These include amounts due to and from agents, brokers and insurance contract holders

(q) Provisions for other liabilities and charges

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, when it is probable that the obligation will result in an outflow of resources to settle the obligation and when a reliable estimate of the amount of the obligation can be made If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

1 Accounting policies (continued)

(r) Investment contracts without DPF

The Company has issued investment contracts without fixed terms (unit-linked) In accordance with industry practice, these contracts are accounted for as financial liabilities, the values of which are contractually linked to the fair values of financial assets within the Company's unitised investment funds The value of the unit-linked financial liabilities is determined using current unit prices multiplied by the number of units attributed to the policyholders at the reporting date The value of the liabilities is never less than the amount payable on surrender, discounted for the required notice period where applicable

The best evidence of the fair value of these financial liabilities at initial recognition is the transaction price unless the fair value of that instrument is evidenced by comparison with other observable market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets Any profit arising on initial measurement of these investment contracts is deferred as a liability for the future investment management services that the Company will render to each policyholder The deferred income balance is recognised over the estimated lives of the contracts, in line with the provision of investment management services unless there is evidence to support an alternative recognition basis

The element of premiums and claims in respect of investment contracts without DPF which is invested or withdrawn on behalf of the policyholder is excluded from the statement of comprehensive income, with all movements in the policyholder liability and related assets being recorded in the balance sheet, within investment contract liabilities Changes in the value of the investment contract liabilities relating to the changes in the value of backing assets are recognised through the statement of comprehensive income, within change in investment contract liabilities

(s) Liability adequacy test

At each reporting date, liability adequacy tests are performed to ensure the adequacy of the insurance contract liabilities net of related deferred costs In performing these tests, current best estimates of future contractual cash flows, claims handling and policy administration expenses, as well as investment income from assets backing such liabilities, are used Any deficiency is immediately charged to the statement of comprehensive income, initially by writing off the relevant assets and subsequently by establishing a provision for losses arising from the liability adequacy tests

(t) Other financial liabilities

Other financial liabilities 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 other financial liabilities

(u) Foreign currency translation

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency") The financial statements are presented in pounds sterling, (rounded to the nearest million ("£m")), which is the Company's presentational and functional currency

Assets and liabilities denominated in foreign currencies are translated into sterling at the exchange rates ruling at the reporting date Revenue transactions and those relating to the acquisition and realisation of investments have been translated at average rates of exchange (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case revenue transactions are translated at the dates of the transactions) Any exchange differences are dealt with in that part of the statement of comprehensive income in which the underlying transaction is reported

(v) Collateral

The Company receives or pledges collateral in the form of cash or securities in respect of derivative transactions it undertakes Derivative collateral pledged or received is recognised as a liability or asset on the balance sheet Derivative collateral that has been received in the form of cash is invested in a cash or cash equivalent investment vehicle which provides immediate liquidity Income from collateral is used to pay the interest obligations to the counterparty

The Company also receives collateral in the form of securities in respect of stock lending agreements Collateral received against stock lent is not recorded on the balance sheet but is appropriately segregated from the assets of the Company

2 Critical accounting estimates and judgments in applying accounting policies

The Company's management makes estimates and judgments that affect the reported amount of assets and liabilities Estimates and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected

(a) Insurance contracts

The estimation of the ultimate liability arising from insurance contracts which are not unit-linked is the Company's most critical accounting estimate

The liabilities are calculated using a projection of future cash flows after making prudent assumptions about matters such as investment return, expenses, credit default and mortality Discount rates used to value the liabilities are set with reference to the risk adjusted yields on the underlying assets The most critical non-economic assumptions are mortality rates in respect of annuity business written and levels of future expenses Such assumptions are based on recent actual experience, supplemented by industry information where appropriate

At each reporting date, the estimates and assumptions referred to above are reassessed for adequacy and changes will be reflected in adjustments to the liability Further information on these balances is given in note 25

Sensitivities regarding changes to key assumptions in calculating insurance contract liabilities are given in note 25

(b) Deferred costs

For insurance contracts, acquisition costs which are incurred during a financial period but which relate to subsequent financial periods are deferred to the extent that they are recoverable out of future revenue margins All other costs are recognised as expenses when incurred The calculation of the deferred acquisition cost asset and its pattern of amortisation requires estimation of both the expected pattern of receipt of future revenue margins and the period that the business is expected to remain in force Further information on this asset is given in note 11

The recognition of costs and income in respect of investment contracts without DPF is governed by IAS 18 'Revenue Under this standard, directly attributable and incremental costs to securing new business are capitalised and are then subsequently amortised over the period of the provision of the investment management services Estimation is required of the period that the business is expected to remain in force and prudent assumptions are required for contracts which do not have a fixed maturity date

(c) Accruals and deferred income

For investment contracts without DPF, the recognition of 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 As above, estimation is required of the period that the business is expected to remain in force and prudent assumptions are required for contracts which do not have a fixed maturity date Further information on this liability is given in note 21

(d) Taxation

The Company recognises current and deferred tax assets in line with IAS 12 Income Taxes" In recognising these assets, management takes into account the likely impact of tax issues that are subject to ongoing discussion with HM Revenue and Customs and other tax authorities With regard to the Company's deferred tax assets, a significant feature is the management judgment applied in determining the timing, sensitivities and probability of them reversing This judgment is based on tax forecasts reflecting new business assumptions, sensitivities and proposed management actions Further information in relation to the Company's current and deferred tax assets is set out at notes 10 and 12

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

3 Fee and commission income

	2009 £ m	2008 £ m
Change in deferred income	0 1	4 6
Other	2 4	3 5
Total	2 5	8 1

4 Investment income

	2009 £ m	2008 £ m
Investments at fair value through income		
Interest income on investments	172 3	91 6
Interest income on deposits	0 1	2 0
Dividend income	261 0	415 7
Rental income on investment properties	7 0	3 1
Other	1 3	(0 1)
Total	441 7	512 3

5. Net realised losses on assets and liabilities at fair value through income

	2009 £ m	2008 £ m
Derivative financial instruments at fair value through income	(31 8)	222 8
Investments at fair value through income	-	-
Equity securities	(104 7)	(515 1)
Debt securities	49 8	63 7
Investment properties at fair value through income	(14 4)	(2 6)
Total	(101 1)	(231 2)

6 Net fair value gains / (losses) on assets and liabilities at fair value through income

	2009 £ m	2008 £ m
Derivative financial instruments at fair value through income	(6 5)	72 3
Investments at fair value through income		
Equity securities	1,360 4	(2,072 2)
Debt securities	(110 8)	66 5
Investment properties at fair value through income	21 4	(35 0)
Foreign exchange	1 0	(0 6)
Total	1,265 5	(1,969 0)

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

7. Operating expenses

	2009 £ m	2008 £ m
Acquisition and origination costs in respect of insurance and investment contracts	130 4	152 5
Expenses for administration	32 9	34 5
	163 3	187 0
Change in deferred costs	1 1	8 3
Total	164 4	195 3

Acquisition and origination costs and expenses for administration can be analysed as follows

	2009 £ m	2008 £ m
Commission payable	106 3	140 8
Auditors' remuneration (see note 9)	0 3	0 1
Other expenses	56 7	46 1
Total	163 3	187 0

The administration of the Company is undertaken by HBOS plc A recharge is levied from this undertaking to the Company in respect of those costs incurred on behalf of the Company

The Company had no direct employees during the year (2008 nil) The employee costs, including pension costs and share-based payment costs, are included in the recharge from HBOS plc noted above

8 Auditors' remuneration

Fees payable for the audit of the statutory accounts for the Company for the year ended 31 December 2009 were £90,629 (2008 £58,705)

Fees payable for the audit of Lloyds Banking Group reporting returns for the Companyfor the year ended 31 December 2009 were £135,943 (2008 nil)

Fees payable for the audit of HBOS plc reporting returns for the Company for the year ended 31 December 2009 were nil (2008 £88,057 3)

Fees payable for services pursuant to legislation for the year ended 31 December 2009 were £48,000 (2008 £48,230)

9 Finance costs

	2009 £ m	2008 £ m
Other interest payable	2 6	4 8
Total	2 6	4 8

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

10 Taxation

(a) Current year tax charge/(credit)

	2009 £m	2008 £m
Current tax·		
UK corporation tax	16 6	32 2
Overseas tax	0 7	-
Adjustment in respect of prior years	0 3	(23 0)
Total current tax	17 6	9 2
Deferred tax:		
Origination/(reversal) of temporary differences	129 9	(334 3)
Adjustment in respect of prior years	(7 4)	6 4
Total deferred tax	122 5	(327 9)
Total income tax charge/(credit)	140 1	(318 7)

The policyholder tax benefit or expense is included in income tax expense Policyholder tax is a charge of £212 8m (2008 credit of £378 4m), including a prior year tax credit of £15 6m (2008 charge of £11 2m)

(b) Reconciliation of tax charge/(credit)

	2009 £m	2008 £m
Profit before tax	30 4	21 4
Tax at 28% (2008. 28 5%)	8 5	6 1
Effects of		
UK tax basis for life insurance profits	(19 7)	106 5
Policyholder tax	142 1	(378 4)
Adjustment to tax charge in respect of prior years	8 5	(27 6)
Overseas tax	0 7	1 7
Other	-	(27 0)
Total	140 1	(318 7)

The Finance Act 2007 reduced the rate of corporation tax from 30% to 28% with effect from 1 April 2008 The impact of this reduction in tax rate, which resulted in a weighted average rate of 28 5% being applied to the profit for the prior year, is reflected in the above table

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

11 Deferred costs

Deferred origination costs

	2009 £ m	2008 £ m
At 1 January	-	5 3
Other movements	-	(5 3)
At 31 December	-	-

Deferred acquisition costs

	2009 £ m	2008 £ m
At 1 January	275 9	278 9
Amounts incurred during the period	73 8	73 2
Amortisation during the period	(74 9)	(81 5)
Other movements	-	5 3
At 31 December	274 8	275 9

Of the above total, £193 1m (2008 £218 6m) is expected to be recovered more than one year after the reporting date

The £5 3m other movement in 2008 is in respect of the Investment Bond product Accidental death cover was added to the product benefits during 2008 The accidental death cover has created insurance risk in respect of the product Therefore from July 2008 it was no longer classed as an investment product under IAS39 Financial Instruments - Recognition and Measurement, but as an insurance product under IFRS4 Insurance contracts

12. Tax assets and liabilities

	2009 £ m	2008 £ m
Current tax receivables	16 6	19 0
Deferred tax assets	265 7	435 8
Total tax assets	282 3	454 8
Current tax payables	31 3	24 4
Deferred tax liabilities	156 5	204 1
Total tax liabilities	187 8	228 5

Deferred tax assets and liabilities included in the above table are expected to be recovered more than one year after the reporting date

(a) Recognised deferred tax

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority The amounts are as follows

	2009 £ m	2008 £ m
Deferred tax assets comprise:		
Expenses deductible in future periods	101 3	90 6
Unrealised losses on investment assets	150 4	345 2
Other insurance related items	14 0	-
Total deferred tax assets	265 7	435 8
Deferred tax liabilities comprise		
Deferred costs	76 9	77 2
Other insurance related items	79 6	126 9
Total deferred tax liabilities	156 5	204 1
Net deferred tax assets	109 2	231 7

The deferred tax balances include an asset of £150 4m (2008 asset of £345 2m) in respect of unrealised losses on investments Cashflow projections undertaken indicate that there will be scope to offset these losses against future taxable profits arising on existing contracts

The tax (charge)/credit in the income statement relating to each of the above items is as follows

	2009 £ m	2008 £ m
Tax on deferred income	-	0 4
Expenses deductible in future periods	(10 7)	31 3
Unrealised gains on investment assets	194 8	(449 8)
Deferred acquisition costs	(0 3)	(2 3)
Other insurance items	(61 3)	92 5
Total deferred tax charge/(credit)	122 5	(327 9)

(b) Unrecognised deferred tax

Deferred income tax assets are recognised for tax loss carry forwards only to the extent that realisation of the related tax benefit is probable

13 Investment properties

	2009 £ m	2008 £ m
At 1 January	106 1	129 5
Additions – new properties	0 1	18 2
Disposals	(39 5)	(6 6)
Net gain/(loss) from change in fair values	21 4	(35 0)
At 31 December	88 1	106 1

The rental income arising from investment properties during the year amounted to £7 0m (2008 £3 1m), which is included in investment income Direct operating expenses (included within operating expenses) arising in respect of such investment properties during the year amounted to £0 2m (2008 £0 0m)

The investment properties are independently valued by Colliers CRE on at least a quarterly basis for the purpose of determining the open market value of the properties

Investment properties are generally recoverable more than one year after the reporting date

14 Derivative financial instruments

In the normal course of business, the Company enters into swap contracts, option contracts, index futures contracts and forward foreign exchange contracts All such contracts are undertaken either for efficient portfolio management purposes or for the purpose of matching contractual liabilities

Swap contracts include interest rate swaps An interest rate swap is an agreement between two parties to exchange fixed and variable rate interest payments based upon interest rates defined in the contract, without the exchange of the underlying principal amount

Option contracts include index and single equity options Such options represent a contract sold by one party to another party offering the right, but not the obligation, to buy or sell a financial asset at an agreed price on a specified future date or within a specified period of time

Index futures contracts are used to hedge the investment portfolio against adverse movements in underlying markets or effecting policy switches between markets without the need to trade the underlying securities Futures may also be used for the purposes of efficient portfolio management provided that their substance would otherwise be permitted as a series of direct transactions

Forward foreign exchange contracts are an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate

Details regarding derivative financial instruments are given in the following tables

	2009			2008		
	Contract Amount £ m	Fair value asset £ m	Fair value liabilities £ m	Contract Amount £ m	Fair value asset £ m	Fair value liabilities £ m
Derivative financial instruments held for trading						
Swap contracts	3,529 8	157 5	14 9	2,750 0	169 0	13 7
Option contracts	3,336 6	13 8	1 6	0 8	6 4	-
Index futures contracts	300 0	1 3	3 6	231 9	-	7 1
Forward foreign exchange contracts	30 5	0 5	-	313 2	23 4	37 9
Total	7,196 9	173 1	20 1	3,295 9	198 8	58 7

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

14 Derivative financial instruments (continued)

Derivative financial instrument assets include £169 2m (2008 £168 8m) that is expected to be recovered more than one year after the reporting date

Derivative financial instrument liabilities include £14 9m (2008 £20 0m) that is expected to be settled more than one year after the reporting date

The amount of £144 1m (2008 £154 7m) was accepted by the Company in assets that it is permitted to sell or repledge in the absence of default of the owner of the collateral No collateral was sold or repledged during the year or in the prior year The Company has an obligation to return these assets to the pledgor

15 Loans and receivables

	2009 £ m	2008 £ m
Insurance business		
Amounts receivable in respect of direct insurance business	10 4	13 1
Amounts receivable under reinsurance contracts	0 3	0 8
Other loans and receivables		
Accrued interest and rent	20 2	23 6
Amounts due from related parties	9 0	35 2
Others	3 0	12 9
Total	42 9	85 6

Of the above total, £Nil (2008 £Nil) is expected to be recovered more than one year after the reporting date

Amounts due from reinsurers represent reinsurance receivables where the Company has the right to cover losses on contracts provided to policyholders

None of the above balances are interest bearing (2008 nil)

There is no significant concentration of credit risk with respect to loans and receivables Further information in respect of credit risk is given in note 26

16. Investments at fair value through income

	2009 £ m	2008 £ m
At fair value.		
Shares and other variable yield securities		
Listed	996 6	626 4
Unlisted	10,272 9	8,308 4
	11,269 5	8,934 8
Debt and other fixed/variable income securities	1,813 7	2,018 9
Total investments at fair value	13,083 2	10,953 7

Of the total debt securities above, £1,484 9m (2008 £1,475 9m) are listed government bonds

Of the debt securities, £1,479 9m (2008 £1,779 7m) is expected to be recovered more than one year after the reporting date Due to the nature of equity securities and investments in pooled investment funds, there is no fixed term associated with these securities

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

16 Investments at fair value through income continued

The Company enters into securities lending transactions and repurchase agreements, whereby cash and securities are temporarily received or transferred as collateral Where the securities sold subject to repurchase are retained on the balance sheet the funds received under these arrangements are recognised as liabilities Assets and liabilities relating to such arrangements at 31 December are as follows

	Asset		Related Liability	
	2009 £m	2008 £m	2009 £m	2008 £m
Equity Investments	-	8 3	-	8 7
Debt Investments	-	861 6	0 1	957 4
Assets subject to repurchase	-	869 9	0 1	966 1

17. Cash and cash equivalents

Cash and cash equivalents for use in the statement of cash flows include the following

	2009 £ m	2008 £ m
Cash at bank	17 6	34 1
Short term deposits	39 6	71 0
Total	57 2	105 1

Cash and cash equivalents in the above table contains amounts of £55 5m (2008 £103 3m) which are held entirely within the long-term insurance funds of the Company These balances are not therefore readily available for use by the Company

18 Share capital

	2009 £ m	2008 £ m
Authorised share capital		
360,000,000 ordinary shares of £1 each	360 0	360 0
Allotted, called up and fully paid share capital		
360,000,000 ordinary shares of £1 each	360 0	360 0

There were no changes in ordinary share capital during the year

19 Insurance contract liabilities

An analysis of the change in insurance contract liabilities and reinsurers' share of insurance contract liabilities is as follows

	2009			2008		
	£ m Gross	£ m Reinsurance	£ m Net	£ m Gross	£ m Reinsurance	£ m Net
At 1 January	10,721 3	100 1	10,621 2	11,995 0	258 8	11,736 2
Provisions in respect of new business	1,865 1	1 4	1,863 7	2,129 9	0 7	2,129 2
Change in existing business provisions	104 0	(24 3)	128 3	(3,402 2)	(159 4)	(3,242 8)
Impact of changes in assumption	0 3	20 8	(20 5)	(1 4)	-	(1 4)
At 31 December	12,690 7	98 0	12,592 7	10,721 3	100 1	10,621 2

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

19 Insurance contract liabilities continued

As the Company is wholly owned by an entity which prepares group financial statements, the Company has taken advantage of the provisions contained in FRS 27 and has not presented a capital position statement and supporting disclosures Information in which the Company is included is given in the financial statements of Lloyds Banking Group plc

An analysis of the contractual and expected maturities of insurance contract liabilities is given in note 26

20 Provisions for other liabilities and charges

	2009 £ m	2008 £ m
At 1 January	-	-
Provisions made during the year	2 1	-
Provisions utilised during the year	-	-
At 31 December	2 1	-

Of the above total, £2 1 (2008 £0m) is expected to be utilised more than one year after the reporting date

21 Accruals and deferred income

	2009 £ m	2008 £ m
Accrued expenses	-	4 0
Deferred income	-	0 1
Total	-	4 1

Of the above total, £Nil (2008 £4 1m) is expected to be settled more than one year after the reporting date

22 Investment contract liabilities

An analysis of the change in net investment contract liabilities is as follows

Investment contract without DPF	2009 £ m Gross	2009 £ m Reinsurance	2009 £ m Net	2008 £ m Gross	2008 £ m Reinsurance	2008 £ m Net
At 1 January	9 9	-	9 9	2,447 6	-	2,447 6
Provisions in respect of new business						
Change in existing business provisions	(1 2)	-	(1 2)	(2,437 7)	-	(2,437 7)
Impact of changes in assumptions	-	-	-	-	-	-
At 31 December	8 7	-	8 7	9 9	-	9 9

An analysis of the contractual and expected maturities of investment contract liabilities is given in note 26

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

23. Other financial liabilities

	2009 £ m	2008 £ m
Insurance business		
Amounts payable in respect of direct insurance business	3 7	3 4
Claims outstanding	110 0	89 2
Amounts payable on reinsurance contracts	0 5	0 4
Other liabilities		
Due to related parties	73 6	42 5
Due to brokers	22 0	12 6
Other	151 3	170 6
Total	361 1	318 7

Of the above total, £140 8m (2008 £132 8m) is expected to be settled more than one year after the reporting date

24 (Increase)/decrease in operating assets and liabilities

	2009 £ m	2008 £m
(Increase) / decrease in operating assets:		
Investment properties	18 0	23 4
Amounts due from reinsurers in respect of insurance contracts	2 1	158 7
Financial assets		
Investments	(2,129 5)	3,448 4
Loans and receivables including insurance receivables	42 7	65 2
Derivative financial instruments	25 7	(130 0)
Net (increase) / decrease in operating assets	(2,041 0)	3,565 7
Increase / (Decrease) in operating liabilities:		
Insurance contract liabilities	1,969 4	(1,273 7)
Financial liabilities		
Investment contract liabilities	(1 2)	(2,437 7)
Derivative financial instruments	(38 6)	54 9
Other financial liabilities	42 4	104 4
Provision for other liabilities and charges	2 1	-
Accruals and deferred income	(4 1)	(0 5)
Net increase / (decrease) in operating liabilities	1,970 0	(3,552 6)
Net (increase) / decrease in operating assets and liabilities	(71 0)	13 1

25 Insurance and investment contract liabilities – assumptions, change in assumptions and sensitivities

All policyholder liabilities are non-profit fund liabilities and are accounted for using a traditional prospective actuarial discounted cash flow methodology

(1) Processes used to determine key assumptions in respect of insurance and investment contracts

Liabilities of the non-profit funds

(a) Insurance contracts

The liabilities of the Company are determined on the basis of recognised actuarial methods and consistently with the approach to be used for the FSA returns The methods used involve estimating future policy cashflows over the duration of the in-force book of policies, and discounting these cashflows back to the valuation date allowing for probabilities of occurrence

The liabilities will vary with movements in interest rates (this applies in particular to the cost of guaranteed benefits payable in the future) and with movements in the cost of life assurance and annuity benefits for which future mortality is uncertain

Assumptions are made in respect of all material factors affecting future cashflows, including future interest rates, mortality and costs Generally, assumptions used to value the liabilities contain a margin for adverse deviation and are determined as required by FSA rules This margin for adverse deviation is based on management's judgment and reflects management's views on the inherent level of uncertainty The assumptions to which the liabilities are most sensitive are the interest rates used to discount the cashflows and the mortality assumptions The key assumptions used in the measurement of the non-profit fund liabilities are

- Interest rates

  The rates used are derived consistently with the approach to be used for the FSA returns These limit the rates of interest that can be used by reference to a number of factors including the dividend and earnings yields on equities rental income and redemption yields on fixed interest assets at the valuation date Margins for risk are allowed for in the assumed interest rates These are derived from the limits contained in the FSA Rules, including reductions made to the available yields to allow for default risk based upon the credit rating of each stock, and an over-riding restriction which limits the yield from investments in property by reference to the yield from appropriate long-term gilts

- Mortality and morbidity

  The mortality and morbidity assumptions are set with regard to the Company's actual experience where this provides a reliable basis, and relevant industry data otherwise, and includes a margin for adverse deviation

- Maintenance expenses

  Allowance is explicitly made for future policy costs Expense loadings are determined by reference to an internal analysis of current and expected future expense levels, plus a margin for adverse deviations Explicit allowance is made for future expense inflation from the valuation date No allowance is made for any expected reductions in expense levels that have not occurred at the valuation date

- Persistency rates

  Prudent lapse rate assumptions have been used for term assurance business Whether a lapse rate is prudent broadly depends on whether the policy is negative or positive at any point in its life, thus for each policy a high lapse rate is assumed at points where the projected liability is negative and a low lapse rate is assumed at points where the projected liability is positive

(b) Investment contracts without discretionary participation feature

These contracts are unit-linked, and the liability is determined as the value of the units allocated to the contracts

(2) Key assumptions

Non-profit funds

The principal assumptions underlying the calculation of the non-profit fund liabilities are given below

(a) Investment returns and discount rates

Class of business	2009 Interest rate (net) %	2008 Interest rate (net) %
Conventional Life business	2 11	2 59
Non-unit reserves on linked business	2 11	3 41

(b) Mortality assumptions

The mortality assumptions for the main classes of business are as follows

Term Assurances		2009	2008
	Males		
	Smoker	109% TMS00U	138% TM92U
	Non-Smoker	86% TMN00U	61% TM92U
	Females		
	Smoker	115% TFS00U	94% TF92U
	Non-Smoker	103 5% TFN00U	94% TF92U

Investment Bonds		2009	2008
	Males	88% AMC00U	72% AM92 U
	Females	83% AFC00U	121% AF92 U

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

(c) Lapse assumptions

The lapse assumptions for the main classes of business are as follows

2009

Description		Average lapse / surrender rate (% pa) for the policy years 1-5	6-10	11-15	16-20
Term Assurances – Life and Critical Illness	Lapse	17 8	15 5	13 0	13 0
Term Assurances - Accelerated Critical Illness	Lapse	23 5	19 0	15 0	15 0
Investment Bonds	Surrender	3 5	6 6	5 6	5 6

2008

Description		Average lapse / surrender rate (% pa) for the policy years 1-5	6-10	11-15	16-20
Term Assurances – Life and Critical Illness	Lapse	22 5	19 3	17 5	13 3
Term Assurances - Accelerated Critical Illness	Lapse	22 5	19 3	17 5	13 3
Investment Bonds	Surrender	2 0	2 0	2 0	2 0

(3) The effect of changes in key assumptions

Non-profit funds

Changes in certain key assumptions were made during 2009 with the following impacts on profit before tax

Variable	Impact on profit before tax 2009 £ m	2008 £ m
Mortality	0 3	-
Expenses	(1 5)	(0 3)

(4) Sensitivity analysis (in respect of insurance contracts only)

Non-profit funds

The following table demonstrates the effect of changes in key assumptions on profit before tax assuming that the other assumptions remain unchanged In practice this is unlikely to occur, and changes in some assumptions may be correlated

Insurance contracts without DPF

Variable	Change in variable	Impact on profit before tax 2009 £ m	2008 £ m
Non annuitant mortality	5% reduction	0 5	1 4
Lapses	10% reduction	-	-
Maintenance expenses	10% reduction	1 7	2 7
Interest rate – change in redemption yield (1)	0 25% reduction	(4 1)	(13 5)

(1) This interest rate sensitivity shows the impact of a 0 25 per cent movement in gilt yields and all of the consequential impacts on key economic assumptions including the risk discount rate, investment returns, the valuation rates of interest and values of assets backing the business in question This excludes any impact on assets not backing the liabilities

26. Risk Management

The Company issues contracts that transfer insurance and financial risk or both This note summarises these risks and the way in which the Company manages them

(a) Governance framework

The Company is part of the Insurance Division of Lloyds Banking Group This Division has established a risk management function with responsibility for implementing the Lloyds Banking Group risk management framework within the Company

The Company assesses the relative costs and concentrations of each type of risk through the Individual Capital Assessment ("ICA") and material issues are escalated to the Insurance Risk Committee, the Clerical Medical Executive Committee and the HBOS FS Board

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 management 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 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 Lloyds Banking Group'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 Lloyds Banking Group risk language which has been adopted across the Company This covers the principal financial risks faced by the Company, including the exposures to market, insurance, credit 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

Lloyds Banking Group retains primary responsibility for the management of investment risks arising in respect of the shareholder funds within the Company These funds are managed in line with the Lloyds Banking Group risk policies

Policy owners, identified from appropriate areas across the business, are responsible for drafting the Lloyds Banking Group 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 each Lloyds Banking Group company can take 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 Company has defined the methodology for the management of risk appetite and has approved appropriate limits Where appropriate for each life company and risk component, limits are defined in terms of the amount of capital required to be held to cover certain specified stressed scenarios

Exposure to each type of risk is monitored against prescribed limits and the results of these tests are reported to senior management

(c) Financial risks

The Company writes a variety of insurance contracts which are subject to a variety of financial risks, as set out below Contracts can be either single or regular premium and conventional (non-profit) or unit-linked in nature

The Company is exposed to a range of financial risks through its financial assets, financial liabilities, reinsurance assets and insurance and investment contract liabilities In particular, the key financial risk is that long-term investment proceeds are not sufficient to fund the obligations arising from its insurance and investment contracts The most important components of financial risk are market, insurance, credit and financial soundness risk

The market risks that the Company primarily faces due to the nature of its investments and liabilities are interest rate, foreign exchange, equity and property risk.

The Company manages these risks in a numbers of ways, including risk appetite assessment and monitoring of capital resource requirements The Company also uses financial instruments (including derivatives) as part of its business activities and to reduce its own exposure to market risk and credit risk

The Company bears financial risk in relation to the guaranteed benefits payable under these contracts The amount of the guaranteed benefits increases as additional benefits are declared and allocated to policies

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

For unit-linked business, policyholders' benefits are closely linked to the investment returns on the underlying internal funds In the short term, profit and equity are therefore largely unaffected by investment returns on assets in internal unit-linked funds as any gains or losses will be largely offset by changes in the corresponding insurance and investment contract liabilities However, any change in the market value of these funds will have an indirect impact on the Company through the collection of annual management and other fund related charges As markets rise or fall, these charges rise or fall correspondingly

For non-profit business, the principal market risk is interest rate risk, which arises because assets and liabilities may exhibit differing changes in market value as a result of changes in interest rates Asset and liability matching is used to mitigate the impact of changes in interest rates where significant exposure exists

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, including fair value gains and losses, are recognised

The following tables analyse the carrying amount of assets and liabilities, with financial assets and financial liabilities being presented according to their IAS 39 classification

	2009 £ m	2008 £ m
Financial assets		
Cash and cash equivalents	57 2	105 1
At fair value through income		
Investments at fair value through income		
- equity securities	11,269 5	8,934 8
- debt securities	1,813 7	2,018 9
Derivative financial instruments	173 1	198 8
At amortised cost		
Loans and receivables	42 9	85 6
Reinsurers' share of insurance contract liabilities	98 0	100 1
	13 454 4	11 443 3
Other assets		
Current tax receivable	16 6	19 0
Investment properties at fair value	88 1	106 1
Deferred tax assets	265 7	435 8
Deferred costs	274 8	275 9
	645 2	836 8
Total assets	14,099 6	12,280 1

	2009 £ m	2008 £ m
Financial liabilities		
Insurance contract liabilities	12,690 7	10,721 3
At fair value through income		
Investment contract liabilities	8 7	9 9
Derivative financial instruments	20 1	58 7
Other financial liabilities	361 1	318 7
	13,080 6	11,108 6
Other liabilities		
Current tax payables	31 3	24 4
Accruals and deferred income	-	4 1
Provisions for other liabilities and charges	2 1	-
Deferred tax liabilities	156 5	204 1
	189 9	232 6
Total liabilities	13,270 5	11,341 2

The timing of the unwind of the deferred tax assets and liabilities is dependent on the timing of the unwind of the temporary timing differences, arising between the tax bases of the assets and liabilities and their carrying amounts for financial reporting purposes, to which these balances relate

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

A maturity analysis of the financial liabilities set out in the above tables is given in the liquidity risk section of this note
The sensitivity analyses given throughout this note are based on a change in an assumption while holding all other assumptions constant In practice, this is unlikely that isolated movements would occur as changes in some of the assumptions may be correlated, for example changes in interest rates and changes in equity values The sensitivity analysis presented represents a reasonably possible change in a single factor

(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 (equity and property risk), 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

Investment holdings within the Company are diversified across markets and, within markets, across sectors Holdings of individual assets are diversified to minimise specific risk and large individual exposures are monitored closely For assets held within unit-linked funds, investments are only permitted in countries and markets which are sufficiently regulated and liquid

Market risk policy is dependent on the nature of the funds in question, and can be broadly summarised as follows

- Assets held in shareholder funds are invested in money market funds, gilts and investment grade bonds in line with the policy of Lloyds Banking Group to optimise shareholder risk and return
- Unit-linked assets are invested in accordance with the nature of the fund mandates
- Conventional non-profit liabilities are "close matched" as far as possible in relation to currency, nature and duration

An analysis of financial assets and financial liabilities at fair value through income according to their fair value hierarchy (as defined in note 1 (c)) is given below

	Fair value hierarchy			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Equity securities	11,269 5	-	-	11,269 5
Debt securities	1,485 0	328 7	-	1,813 7
Derivative financial instruments	1 2	171 9	-	173 1
Total assets	12,755 7	500 6	-	13,256 3
Derivative financial instruments	3 6	16 5	-	20 1
Investment contract liabilities	-	8 7	-	8 7
Total liabilities	3 6	25 2	-	28 8

Total gains or losses for the period included in the statement of comprehensive income as well as total gains or losses relating to assets and liabilities held at the reporting date are presented in the statement of comprehensive income, through net realised gains and losses on assets and liabilities at fair value through income and net fair value gains and losses on assets and liabilities at fair value through income respectively

In accordance with the transitional provisions of the amendment to IFRS 7 which introduced the above reconciliation, no comparative data has been provided

(i) Equity and property risk

The exposure of the Company's insurance and investment contract business to equity and property risk relates to financial assets and financial liabilities whose values will fluctuate as a result of changes in market prices other than from interest and foreign exchange fluctuations This is due to factors specific to individual instruments, their issuers or factors affecting all instruments traded in the market Accordingly, the Company monitors exposure limits both to any one counterparty and any one market

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

The sensitivity analysis below illustrates the impact on profit and shareholder equity of changes in equity and property prices, net of offsetting movements in insurance and investment contract liabilities, at the reporting date

	Impact on profit after tax and equity for the year	
	2009	2008
	£ m	£ m
10% (2008 10%) increase in equity prices	1 2	11 1
10% (2008 10%) decrease in equity prices	(1 2)	(11 1)
10% (2008 10%) increase in property prices	-	0 4
10% (2008 10%) decrease in property prices	-	(0 4)

(ii) 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 in respect of the Company's insurance and investment contracts arises when there is a mismatch in duration or yield between liabilities and the assets backing those liabilities

A fall in market interest rates will result in a lower yield on the assets supporting guaranteed investment returns payable to policyholders This investment return guarantee risk is managed by matching assets to liabilities as closely as possible

An increase in market interest rates will result in a reduction in the value of assets subject to fixed rates of interest which may result in losses if, as a result of an increase in the level of surrenders, the corresponding fixed income securities have to be sold

The effect of changes in interest rates in respect of financial assets which back insurance contract liabilities is given in note 25 The effect on the Company of changes in the value of investments held in respect of investment contract liabilities due to fluctuations in market interest rates is negligible as any changes will be offset by movements in the corresponding liability

The sensitivity analysis below illustrates the impact on profit and shareholder equity of changes in interest rate yields on interest-bearing financial assets, net of offsetting movements in insurance and investment contract liabilities, at the reporting date

	Impact on profit after tax and equity for the year	
	2009	2008
	£ m	£ m
25 basis points (2008 25 basis points) increase in yield curves	7 4	8 1
25 basis points (2008 25 basis points) decrease in yield curves	(7 4)	(8 4)

The prior year sensitivity set out above has been amended to present the profit and equity impact of the stated change in interest rates on the same basis as the current year calculation

(iii) Foreign exchange risk

Foreign exchange risk relates to the effects of movements in exchange markets including changes in exchange rates The overall risk to the Company is minimal due to the following

- The Company's principal transactions are carried out in pounds sterling,
- The Company's financial assets are primarily denominated in the same currencies as its insurance and investment contract liabilities, and
- Other than shareholder funds, all non-linked investments of the non-profit funds are in sterling or are currency matched The effect on the Company of changes in the value of investments held in respect of investment contract liabilities due to fluctuations in foreign exchange rates is negligible as any changes will be offset by movements in the corresponding liability

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

(2) Insurance risk

Insurance risk is the risk of reductions in earnings and/or value, through financial or reputational loss, due to fluctuations in the timing, frequency and severity of insured/underwritten events and to fluctuations in the timing and amount of claim settlements This includes fluctuations in profits due to customer behaviour The principal risk the Company faces under insurance contracts is that the actual claims and benefit payments exceed the amounts expected at the time of determining the insurance liabilities

The nature of the Company s business involves the accepting of insurance risks which primarily relate to mortality, morbidity, persistency and expenses

The Company principally writes the following types of life insurance contracts

- Life assurance – where the life of the policyholder is insured against death or permanent disability, usually for pre-determined amounts
- Morbidity products – where the policyholder is insured against the risk of contracting a defined illness

For contracts where death is the insured risk, the most significant factors that could increase the overall level of claims are epidemics or widespread changes in lifestyle, such as eating, smoking and exercise habits, resulting in earlier or more claims than expected The possibility of a pandemic arising from Swine Flu is regarded as a potentially significant mortality risk

For contracts where survival is the insured risk, the most significant factor is continued improvement in medical science and social conditions that would increase longevity

For contracts with fixed and guaranteed benefits and fixed future premiums, there are no mitigating terms and conditions that significantly reduce the insurance risk accepted

Insurance risk is also affected by the policyholders' right to pay reduced or no future premiums or to terminate the contract completely As a result, the amount of insurance risk is also subject to policyholder behaviour On the assumption that policyholders will make decisions that are in their best interests, overall insurance risk will generally be aggravated by policyholder behaviour For example, it is likely that policyholders whose health has deteriorated significantly will be less inclined to terminate contracts insuring death benefits than those policyholders who remain in good health

The Company has taken account of the expected impact of policyholder behaviour in setting the assumptions used to measure insurance and investment contract liabilities

The principal methods available to the Company to control or mitigate longevity, mortality and morbidity risk are through the following processes

- Underwriting (the process to ensure that new insurance proposals are properly assessed),
- Pricing-to-risk (new insurance proposals would usually be priced in accordance with the underwriting assessment),
- Claims management,
- Product design,
- Policy wording,
- Product Management, and
- The use of reinsurance and other risk mitigation techniques

Rates of mortality and morbidity are investigated annually based on the Company's recent experience and future mortality assumptions are set using the latest population data available Each Company's reinsurance arrangements are reviewed at least annually

Persistency risk is the risk associated with the ability to retain long-term business and the ability to renew short-term business The Company aims to reduce its exposure to persistency risk through revising the commission structure on future product developments and undertaking various initiatives to promote customer loyalty

Further information on assumptions, changes in assumptions and sensitivities in respect of insurance contracts is given in note 25

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

(3) 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 (both on and off balance sheet)

Investment counterparty default risk arises primarily from holding invested assets to meet liabilities, and reinsurer default credit risk primarily arises from exposure to reinsurers

Credit risk in respect of unit-linked funds is borne by the policyholders Consequently, the Company has no significant exposure to credit risk for those funds The tables in this section reflect the credit risk on assets held within these funds, but do not take account of the offsetting reduction in liabilities to unit-linked policyholders that would be expected in the event of default

For non-linked funds investments, limits on the exposure to a single entity are specified and monitored Bond exposures are managed through credit rating bands and maximum exposures to individual assets and sectors are set Assets are restricted to securities in a specified list of countries, and limits applicable to property portfolios are set to prevent concentration of exposure to single tenants and single buildings

Shareholder funds are managed in line with the Lloyds Banking Group Credit Risk Policy and the principles are the same as those outlined above in respect of non-linked funds

Reinsurance is primarily used to reduce insurance risk However, it is also sought for other reasons such as improving profitability, reducing capital requirements and obtaining technical support In addition, reinsurance is also used to offer Investment Fund Links which we are unable to provide through other means The Company's reinsurance strategy is to reduce the volatility of profits through the use of reinsurance whilst managing the insurance and credit risk within the constraints of the risk appetite limits

The Company has reinsurance on lines of business where mortality or morbidity risk exceeds set retention limits This does not, however, discharge the Company's liability as primary insurer If a reinsurer fails to pay a claim for any reason, the Company remains liable for the payment to the policyholder All new material reinsurance treaties are subject to Board approval and all reinsurance arrangements are reviewed annually to ensure that the reinsurance strategy is being achieved This includes an assessment of the exposure to each reinsurer to ensure that it is within the defined limit

Policies are treated as lapsed when payments from the policyholder have not been received for a period of time and the policyholder has not provided further information in respect of the non-payment of premiums

Exposure to other trade debtors is assessed on a case by case basis, using a credit rating agency where appropriate

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

	2009 £ m	2008 £ m
At fair value through income		
Liquidity funds classed as equity	3,666 3	3,156 6
Debt securities	1,813 7	2,018 9
Derivative financial instruments	173 1	198 8
At amortised cost		
Loans and receivables	42 9	85 6
Reinsurers' share of insurance contract liabilities	98 0	100 1
Cash and cash equivalents	57 2	105 1
Total assets bearing credit risk	5,851 2	5,665 1

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

The tables below analyse financial assets subject to credit risk using Standard & Poor's rating or equivalent Limits are not applied to investments in funds falling under the UCITS Directive

As at 31 December 2009

	Total £ m	AAA £ m	AA £ m	A £ m	BBB or lower £ m	Not rated £ m
Liquidity funds classed as equity	3,666 3	3,666 3	-	-	-	-
Debt securities	1,813 7	1,755 8	1 0	56 9	-	-
Derivative financial instruments	173 1	158 4	0 5	14 2	-	-
Reinsurers' share of insurance contract liabilities	98 0	98 0	-	-		-
Loans and receivables	42 9	9 0		0 4	-	33 5
Cash and cash equivalents	57 2	17 1	19 8	20 3	-	-
Total	**5,851 2**	**5,704 6**	**21 3**	**91 8**	**-**	**33 5**

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

As at 31 December 2008

	Total £ m	AAA £ m	AA £ m	A £ m	BBB or lower £ m	Not rated £ m
Liquidity funds classed as equity	3,156 6	3,156 6	-	-	-	-
Debt securities	2,018 9	1,745 4	71 7	201 8	-	-
Derivative financial instruments	198 8	-	-	198 8	-	-
Reinsurers' share of insurance contract liabilities	100 1	-	(19 5)	119 6	-	-
Loans and receivables	85 6	-	-	35 2	-	50 4
Cash and cash equivalents	105 1	-	33 4	71 7	-	-
Total	**5,665 1**	**4,902 0**	**85.6**	**627.1**	**-**	**50.4**

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

Included in the loans and receivables balance above is £0m (2008 £0m) in respect of assets that were past due but not impaired at the reporting date There were no impaired assets at 31 December 2009 or 31 December 2008 No terms in respect of financial assets had been renegotiated at 31 December 2009 or 31 December 2008

(i) Concentration risk

Credit concentration risk relates to the inadequate diversification of credit risk This risk is managed through compliance with the fund mandates in place for those funds As previously stated, defaults on unit-linked funds would be matched by an offsetting reduction in liabilities to unit-linked policyholders

Each mandate sets out the permitted asset types within each fund with a minimum and maximum permitted holding by asset type, and within each asset type there are further restrictions set down by credit rating of the assets held Counterparty limits are set out within those by asset types according to the credit rating of the instruments held – these vary by mandate according to the stated fund objective

The portfolio of mandates is reviewed at least annually and within the non-profit and shareholder funds is designed to set counterparty risk thresholds that are lower than those required for FSA reporting

The only assets permitted to be held with no limit on concentration risk in any fund mandate are UK Treasury securities These are unlimited, with holdings at 31 December 2009 being £1,484 9m (2008 £1,473 4m), of which £1,484 9m (2008 £1,458 9m) was held in unit-linked funds

The largest exposures to which counterparty limits are applied in the fund mandates are to the range of Insight liquidity funds These AAA rated funds have UCITS status and a diverse portfolio of investments Exposure across these liquidity funds totalled £2,714 7m (2008 £3,207 3m), of which £1,836 9m (2008 £2,816 9m) was held in unit-linked funds

Other than UK Treasury securities and liquidity fund investments, the Company did not have any significant concentration of credit risk with a single counterparty or group of counterparties where limits applied at 31 December 2009 or 31 December 2008 The next largest exposure at 31 December 2009, without taking into account collateral held or other credit enhancements, was to HBOS Investment Fund Managers Limited Cautious Managed OEIC totalling £2,156 7m (2008 HBOS Investment Fund Managers Limited Cautious Managed OEIC totalling £1,637 0m) and this represented 16% of the investments held (2008 15%) £2,156 7m of the exposure to HBOS Investment Fund Managers Limited Cautious Managed OEIC was held in the unit-linked funds (2008 £1,637 0m)

The Company maintains strict control limits on the derivative positions held by each fund as set out in the Insurance Division Derivatives Policy

(ii) Collateral management

<u>Collateral in respect of OTC derivatives</u>

The requirement for collateralisation, including the levels at which collateral is required and the types of asset that are deemed to be acceptable collateral, are set out in a Credit Support Annex ("CSA") A CSA is a bilateral legal agreement which, once signed, forms part of the International Swaps and Derivatives Association ("ISDA") agreement between the Company and the counterparty

A CSA must be completed for OTC derivatives as part of the contracts for such transactions The CSA will require collateralisation where any net exposure to a counterparty exceeds the OTC counterparty limit, which must be established in accordance with the Insurance Division's Risk Policy The aggregate uncollateralised exposure to any one counterparty must not exceed limits specified in the Insurance Division's Derivatives Policy Where derivative counterparties are related, the aggregate net exposure is considered for the purposes of applying these limits

Collateralisation is the pledging or receiving of assets as a guarantee against the fulfilment of a future obligation, normally through a cash transfer or asset delivery

The aggregate exposure, net of any collateralisation, to any one counterparty, across all funds and transactions, should not exceed £225m

Collateral is pledged or received in cash and cash equivalents

At 31 December 2009, no assets (2008 nil) had been pledged in accordance with the terms of the relevant CSAs in respect of OTC derivative contracts

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

The policy of the Company is not to repledge assets In the event of default, assets received as collateral are sold Collateral with a fair value of £nil (2008 £nil) was sold during the year At 31 December 2009, assets with a fair value of £144 1m (2008 £154 7m) were available to the Company to sell in the absence of default by the counterparty None of these assets were past due or impaired at 31 December 2009 or 31 December 2008

Collateral held in respect of OTC derivatives at 31 December 2009 had a fair value of £144 1m (2008 £154 7m)

All collateral held relates to fully performing assets

Collateral in respect of securities lending

The Company enters into securities lending transactions The Insurance Division's Investment Control Committee is responsible for setting the parameters of securities lending and therefore changes to these parameters The accepted collateral can include cash, equities, certain bonds and money market instruments On a daily basis, the fair value of collateral is compared to the fair value of stock on loan The value of collateral must always exceed the value of stock on loan

Securities lending is permitted in accordance with the Insurance Division's Credit Risk Policy on securities lending All securities lending takes place on an open/call basis, enabling the loan to be recalled at any time within the standard settlement terms of the market concerned

The policy requires all lending to be undertaken via a partial indemnified programme (where the operator of the programme provides an indemnification against borrower and collateral default) [Placeholder Investment Governance is under review so this may be subject to change] The partial programme does not cover the re-investment of outright cash and therefore the policy specifies that the Insurance Division's Investment Control Committee will set counterparty limits for the re-investment of such balances

Additionally, the Insurance Division's Investment Control Committee will set limits on the maximum amount of any security that may be lent and the markets in which lending can take place

The policy requires acceptable collateral to be pledged to at least the value of securities lent and sets specific parameters over what qualifies as acceptable collateral

There were no collateral defaults in respect of securities lending during the year ended 31 December 2009 which required a call to be made on collateral During 2008 possession was taken of collateral held on securities lending transactions with Lehman Brothers, following the collapse of that company The fair value of the collateral obtained totalled £4m, and principally comprised of debt and equity instruments as permitted under the lending agreement governing the transactions at the time There was no impact on profit before tax relating to the recovery

(4) 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

(i) Financial and prudential regulatory reporting, tax and disclosure risks

The Company is exposed to the risk that policies and procedures are not sufficient to maintain adequate books and records to support statutory, regulatory and tax reporting and to prevent and detect financial reporting fraud

The Company has developed procedures to ensure that compliance with both current and potential future requirements are understood and that policies are aligned to its risk appetite The Company maintains a system of internal controls, consistently applied, providing reasonable assurance that transactions are recorded and undertaken in accordance with delegated authorities that permit the preparation and disclosure of financial statements (including consolidated financial statements), regulatory reporting and tax returns in accordance with IFRSs, statutory and regulatory requirements

The Company undertakes a programme of work designed to support an annual assessment of the effectiveness of internal controls over financial reporting, to identify tax liabilities and to assess emerging legislation and regulation

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

(ii) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in raising funds to meet its financial commitments as they fall due, or can secure them only at an excessive cost Liquidity risk may result from either the inability to sell financial assets quickly at their fair values, or from an insurance liability falling due for payment earlier than expected, or from the inability to generate cash inflows as anticipated

Liquidity risk has been analysed as arising from payments to policyholders (including those where payment is at the discretion of the policyholder) and non policyholder related activity (such as investment purchases and the payment of shareholder expenses)

Liquidity risk in respect of each of the major product areas is primarily mitigated as follows

Non-profit contracts

For unit-linked products, portfolios are invested in accordance with unit fund mandates Deferral clauses are included in policyholder contracts to give time, when necessary, to realise linked assets without being a forced seller As at 31 December 2009, there are no funds under management subject to deferral

A manager's box is also held to mitigate the risk of normal disinvestments in the course of business A disinvesting policyholder receives the closing price on the date of surrender This price can be affected by the level of disinvestment thereby deferring the liquidity risk to the policyholder

For non linked products, investments are mostly held in gilts with minimal liquidity risk Investments are arranged to minimise the possibility of being a distressed seller whilst at the same time investing to meet policyholder obligations. This is achieved by anticipating policyholder behaviour and sales of underlying assets within funds

Shareholder funds

For shareholder funds, liquidity risk is managed in line with the Lloyds Banking Group Funding and Liquidity Risk Policy

The following tables indicate the timing of the contractual cashflows arising from the Company's financial liabilities, as required by IFRS 7 Liquidity risk in respect of insurance contract liabilities has been analysed based on the expected pattern of maturities as permitted by IFRS 4 'Insurance Contracts' rather by contractual maturity A maturity analysis of investment contracts based on expected contract maturities is also given as it is considered that this analysis provides additional useful information in respect of the liquidity risk relating to contracts written by the Company

As at 31 December 2009

Liabilities	Carrying amount*	Contractual cashflows (undiscounted)					
		No stated maturity	Less than 1 month	1-3 months	3-12 months	1-5 years	More than 5 years
	£ m	£ m	£ m	£ m	£ m	£ m	£ m
Investment contract liabilities	8.7	-	8.7	-	-	-	-
Derivative financial instruments	20.1	-	-	3.7	1.5	14.9	-
Other financial liabilities	361.1	-	216.4	1.4	16.3	127.0	-
Total	389.9	-	225.1	5.1	17.8	141.9	-

*The carrying amount is presented on a discounted basis In accordance with IFRS 7, the contractual cashflows are presented on an undiscounted basis

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

As at 31 December 2008

Liabilities	Carrying amount* £ m	No stated maturity £ m	Contractual cashflows (undiscounted) Less than 1 month £ m	1-3 months £ m	3-12 months £ m	1-5 years £ m	More than 5 years £ m
Investment contract liabilities	9 9	-	9 9	-	-	-	-
Derivative financial instruments	58 7	-	11 1	33 8	0 8	13 0	-
Other financial liabilities	318 7	-	181 6	2 1	4 0	131 0	-
Total	387 3	-	202 6	35 9	4 8	144 0	-

*The carrying amount is presented on a discounted basis In accordance with IFRS 7, the contractual cashflows are presented on an undiscounted basis

The contractual cashflow analysis set out above has been based on the earliest possible contractual date, regardless of the surrender penalties that might apply and has not been adjusted to take account of such penalties

An analysis of insurance and investment contract liabilities by expected contract maturity, on a discounted basis, is shown below

As at 31 December 2009

Maturity Analysis for insurance and investment contract liabilities	Total £ m	Less than 1 month £ m	1-3 months £ m	3-12 months £ m	1-5 years £ m	More than 5 years £ m
Insurance contract liabilities	12,690 7	436 5	748 8	1,144 3	3,364 5	6,996 6
Investment contract liabilities	8 7	0 5	1 0	4 2	3 0	-

As at 31 December 2008

Maturity Analysis for insurance and investment contract liabilities	Total £ m	Less than 1 month £ m	1-3 months £ m	3-12 months £ m	1-5 years £ m	More than 5 years £ m
Insurance contract liabilities	10,721 3	82 3	161 6	749 1	3,266 2	6,462 1
Investment contract liabilities	9 9	0 2	0 4	2 7	6 6	-

(iii) Capital risk

Capital risk is defined as the risk that

- the Company has insufficient capital to meet its regulatory capital requirements,
- the Company has insufficient capital to provide a stable resource to absorb all losses up to a confidence level defined in the risk appetite,
- the Company loses reputational status by having capital that is regarded as inappropriate, either in quantity, type or distribution, and/or
- the capital structure is inefficient

The FSA specifies the minimum amount of capital that must be held by the Company in addition to their insurance liabilities Under the FSA rules, the company must hold assets in excess of the higher of

(i) the Pillar 1 amount, which is calculated by applying fixed percentages to premiums and claims, and

(ii) the Pillar 2 amount, which is derived from an economic capital assessment undertaken by each regulated company, which is reviewed by the FSA

The minimum required capital must be maintained at all times throughout the year The fair value surplus is regularly estimated in order to ensure that capital maintenance requirements are being met

The Company's objectives when managing capital are

- to comply with the insurance capital requirements set out by the FSA in the UK,
- to have sufficient further capital to safeguard the Company's ability to continue as a going concern so that it can continue to provide returns for the shareholder and benefits for other stakeholders,
- when capital is needed, to require an adequate return to the shareholder by pricing insurance and investment contracts according to the level of risk associated with the business written.

The Company manages the capital structure and makes adjustments to reflect changes in economic conditions and the risk characteristics of the underlying assets In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to the shareholder, return capital to the shareholder, issue new shares or sell assets

The Company's capital comprises all components of equity, movements in which are set out in the statement of changes in equity

The table below sets out the regulatory capital and the required capital held at 31 December in each year on a Pillar 1 basis The current year information is, in general, an estimate that will be updated once the FSA returns for the year are finalised

	2009 £ m	2008 £ m
Regulatory capital held	517 0	428 1
Regulatory capital required	249 3	269 0

All minimum regulatory requirements were met during the year

(d) Legal and regulatory risks

The Company also faces a number of legal and regulatory risks, reflecting the volume and pace of change within the UK This impacts the Company both operationally, in terms of costs of compliance and uncertainty about regulatory expectations, and strategically, through pressure on key earnings streams The latter could potentially result in major changes to business and pricing models, particularly in the UK retail market Business planning processes continue to reflect change to the regulatory environment

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

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

27 Related party transactions

(a) Ultimate parent and shareholding

The Company's immediate parent undertaking is Halifax Life Limited, a company registered in the United Kingdom

The Company's ultimate parent company and ultimate controlling party is Lloyds Banking Group plc, 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 Copies of the Lloyds Banking Group plc 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

<u>Transactions between the Company and other companies in the Lloyds Banking Group</u>

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

Counterparty	Transaction type	Relationship	2009 £ m	2008 £ m
HBOS plc	Insurance business balance	Fellow group undertaking	(17 0)	18 4
	Insurance business transactions	Fellow group undertaking	1,258 3	370 8
Halifax Life Ltd	Reassurance business balance	Parent undertaking	1 3	5 5
	Reassurance business transactions	Parent undertaking	185 4	480 3
HBOS Financial Services Ltd	Expense Recharge balance	Fellow group undertaking	(6 0)	(12 5)
	Expense Recharge transactions	Fellow group undertaking	(43 9)	(56 7)
Bank of Scotland plc	Bank account balances	Fellow group undertaking	24 8	32 3
	Bank account transactions	Fellow group undertaking	(7 5)	13 3
Bank of Scotland plc	Insurance business balance	Fellow group undertaking	(4 1)	(0 9)
	Insurance business transactions	Fellow group undertaking	277 9	277 7
Halifax Insurance Ireland Ltd	Insurance business balance	Fellow group undertaking	5 3	6 2
	Insurance business transactions	Fellow group undertaking	69 1	55 8
Halifax General Insurance Services Ltd	Expense Recharge balance	Fellow group undertaking	-	1 0
	Expense Recharge transactions	Fellow group undertaking	(1 0)	0 7
Clerical Medical Investment Fund Managers Ltd	Insurance business balance	Fellow group undertaking	-	-
	Insurance business transactions	Fellow group undertaking	0 1	0 1
Birmingham Midshires	Insurance business balances	Fellow group undertaking	-	(0 1)
	Insurance business transactions	Fellow group undertaking	(0 5)	(0 1)
Capital Bank	Profit commission balance	Fellow group undertaking	2 4	(1 2)
	Profit commission transactions	Fellow group undertaking	1 0	1 3
St Andrews Group Plc	Expense Recharge balance	Fellow group undertaking	(40 8)	(26 4)
	Expense Recharge transactions	Fellow group undertaking	(17 0)	(14 8)
HBOS Investment Fund Managers Ltd	Investment Management Fees balance	Fellow group undertaking	(1 5)	(0 4)
	Investment Management Fee transactions	Fellow group undertaking	(13 0)	(14 7)
Insight Investment Management Ltd	Investment Management Fees balance	Fellow group undertaking	-	(1 0)
	Investment Management Fee transactions	Fellow group undertaking	(6 9)	(9 5)
Scottish Widows Investment Partnership Ltd	Investment Management Fees balance	Fellow group undertaking	(0 7)	-
	Investment Management Fee transactions	Fellow group undertaking	(0 7)	-
Invista Real Estate Investment	Investment Management Fees balance	Fellow group undertaking	-	-
	Investment Management Fee transactions	Fellow group undertaking	(0 4)	-
AA Personal Finance Ltd	Profit commission balance	Fellow group undertaking	(2 7)	-
	Profit commission transactions	Fellow group undertaking	(2 7)	-
Membership Services Finance Ltd	Profit commission balance	Fellow group undertaking	(0 1)	-
	Profit commission transactions	Fellow group undertaking	-	-

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

Counterparty	Transaction type	Relationship	2009 £ m	2008 £ m
Lloyds Banking Group plc	Investment balance	Ultimate parent undertaking	253 6	-
	Investment Transactions	Ultimate parent undertaking	251 9	-
AA Financial Services Ltd	Profit Commission balance	Fellow group undertaking	(0 4)	-
	Profit Commission transactions	Fellow group undertaking	(0 4)	-
Britannia Personal Lending Ltd	Profit Commission balance	Fellow group undertaking	(0 1)	-
	Profit Commission transactions	Fellow group undertaking	(0 1)	-
Home Shopping Personal Finance Ltd	Profit Commission balance	Fellow group undertaking	(0 1)	-
	Profit Commission transactions	Fellow group undertaking	(0 1)	-
HBOS Treasury Services Ltd	Derivative instrument balance	Fellow group undertaking	4 5	-
	Derivative instrument transactions	Fellow group undertaking	4 5	-

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

The emoluments of Directors providing services to the Company are

	2009 £	2008 £
Total emoluments	146,779	175,120
Pension contributions and entitlements	15,468	22,988
Other long-term benefits	14,482	1,720
Termination benefits	-	-
Share-based Payments	-	21,219

Retirement benefits are accruing to 2 Directors (2008 3) under a defined benefit scheme

Directors sit on several boards and their benefits are allocated to a company depending on the proportion of their time that they spend as a director of that company

Life assurance contracts

	Number of key management personnel	£000
Valuation as at 1 January 2009 or date of appointment, if later	1	17 0
Premiums paid/amounts invested during the year	-	-
Other movements including investment returns	1	(1 7)
Balance upon resignation of office	1	15 3
Total sum insured/value of investment at 31 December 2009	-	-

Other transactions

HM Treasury

On 13 January 2009, HM Treasury subscribed for 2,597 million shares in Lloyds Banking Group plc, the Company's ultimate parent company On 16 January 2009, Lloyds Banking Group acquired HBOS plc in an all share acquisition which, together with the shares subscribed for on 13 January 2009, gave HM Treasury a 43 38 per cent interest in Lloyds Banking Group's ordinary share capital and, consequently, HM Treasury became a related party of the Company from this date

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

There were no material transactions between the Company and HM Treasury during the period between 13 January 2009 and 31 December 2009 that were not made in the ordinary course of business or that are unusual in their nature or conditions In addition, the Company have 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 Owing to the volume and diversity, such transactions are not disclosed

28 Stocklending

The aggregate value of securities on loan by the Company is nil (2008 £869 9m) Securities on loan are included in investments at fair value through income and no account is taken of collateral held The aggregate value of collateral held is nil (2008 £966 1m) This collateral was in the form of high quality bonds and cash. Further detail in respect of collateral is provided in note 26

29 Standards and interpretations effective in 2009

The following 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 the year ended 31 December 2009 Their relevance to the Company's operations is assessed below

- Amendment to IAS 23 "Borrowing Costs" This standard requires that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should form part of the cost of that asset Other borrowing costs should be recognised as an expense The amendment removes the previously allowable alternative treatment of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale Adoption of this standard has had no impact on the financial results or position of the Company as the alternative treatment previously allowed under IAS 23 was not adopted

- Amendment to IAS 1 "Presentation of Financial Statements" This standard sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content All changes in equity in respect of transactions with shareholders in their capacity as shareholders are required to be presented separately from changes in equity arising from transactions with other parties ('non-owner"), in a statement of changes in equity All non-owner changes in equity (comprehensive income) are required to be presented in one statement of comprehensive income or in two statements (an income statement and a statement of comprehensive income) The changes required on adoption of this standard relate only to presentation and disclosure and have therefore had no overall impact on the financial results or position of the Company other than to rename the income statement as the statement of comprehensive income and the cash flow statement as the statement of cash flows IAS 1 has been further amended by an amendment to IAS 32, details of which are set out in later in this section

- Amendments to IAS 1 "Presentation of Financial Statements" and IAS 32 "Financial Instruments Presentation" The amendments are relevant to entities that have issued financial instruments that are (i) puttable financial instruments (instruments which allow the holder to require the issuer to redeem the instruments for cash), or (ii) instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation Under the revised IAS 32, subject to extensive detailed criteria being met, such instruments will be classified as equity whereas, prior to these amendments, they would have been classified as financial liabilities The amendments will require reclassifications from or to equity when the specified criteria are no longer met, or when they are subsequently met IAS 1 has been amended to require disclosure of (i) summary quantitative data about the amount classified as equity, (ii) the entity's objectives, policies and processes for redeeming the instruments, and (iii) the expected cash outflow on redemption and how this has been calculated in respect of a puttable financial instrument which has been classified within equity These amendments have not yet been endorsed by the EU but adoption would have had no impact on the financial results or position of the Company

- Improvements to International Financial Reporting Standards 2008 (majority of changes effective for accounting periods beginning on or after 1 January 2009) – this is the first standard published under the IASBs annual improvements process, which is intended to deal with non-urgent, minor amendments to standards The standard includes 35 amendments and is split into two parts (i) amendments that result in accounting changes for presentation, recognition or measurement purposes, and (ii) amendments that are terminology or editorial changes only Adoption of this standard has had only a minor impact on some of the disclosures given in the Company financial statements

- Amendments to IAS 39 'Financial Instruments Recognition and Measurement" and IFRIC 9 "Reassessment of embedded derivatives' This amendment clarifies the consequences if the fair value of an embedded derivative that would have to be separated from its host contract cannot be measured reliably These amendments have not yet been endorsed by the EU but adoption of these amendments would have had no impact on the financial results or position of the Company

- Amendment to IFRS 7 'Financial Instruments Disclosures" The amendments introduce enhanced disclosures about fair value measurement and liquidity risk For fair value measurements, a three level hierarchy has been introduced A financial instrument should be classified into one of these levels in its entirety, with the appropriate level in the hierarchy being determined on the basis of the lowest level input that is "significant" to the fair value measurement Adoption of these amendments has resulted in additional quantitative disclosure being provided in the relevant notes The amendments in respect of liquidity risk clarify the scope of items to be included in the maturity analyses required by IFRS 7 by changing the definition of liquidity risk to include only financial liabilities that are settled by delivering cash or another financial instrument The amendments also clarify that a hybrid contract that is a financial liability should not be separated into a host contract and related embedded derivative for the purpose of the maturity analysis Adoption of these amendments has had no impact on the liquidity risk disclosures provided by the Company

30 Standards and interpretations in issue but not adopted early

The following standards, amendments to and interpretations of published standards have been issued and will be relevant to the Company's operations but have not been adopted early by the Company

- Amendment to IAS 39 "Financial Instruments Recognition and Measurement" (effective for accounting periods beginning on or after 1 July 2009) This amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for hedge designation should be applied in particular situations Adoption of this amendment will have no impact on the financial results or position of the Company This amendment has not yet been endorsed by the EU

- Improvements to International Financial Reporting Standards 2009 (majority of changes effective for accounting periods beginning on or after 1 January 2010) This is the second standard published under the IASBs annual improvements process, which is intended to deal with non-urgent, minor amendments to standards The standard includes amendments to 12 standards Adoption of this standard will have no impact on the financial results, financial position or disclosures given in the Company financial statements This standard has not yet been endorsed by the EU

- Amendment to IAS 24 'Related Party Disclosures' (effective for accounting periods beginning on or after 1 January 2011) This revised standard simplifies the disclosure requirements for entities that are controlled, jointly controlled or significantly influenced by a government and clarifies the definition of a related party A partial exemption is provided from the disclosure requirements of IAS 24 for government-related entities, meaning that there is no need to disclose related party transactions and outstanding balances (including commitments) with (i) a government that has control, joint control or significant influence over the reporting entity and (ii) an other entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the related entity The amendment also simplifies the definition of a related party, clarifies its intended meaning and eliminates a number of inconsistencies Adoption of this amendment will have no impact on the financial results, financial position or disclosures given in the Company financial statements This amendment has not yet been endorsed by the EU

- IFRS 9 "Financial Instruments Part 1 Classification and Measurement" (effective for accounting periods beginning on or after 1 January 2013) IFRS 9 replaces those parts of IAS 39 relating to the classification and measurement of financial assets Under IFRS 9, only two measurement categories are available being fair value through profit or loss and amortised cost Previously, categories of available-for-sale and held-to-maturity were also available The decision on classification is made at initial recognition and will depend on an entity's business model for managing its financial instruments and the contractual cash flow characteristics of the financial instruments An instrument is subsequently measured at amortised cost only if it is a debt instrument and (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent only payments of principal and interest All other debt instruments are to be measured at fair value through profit or loss All equity instruments are to be subsequently measured at fair value Gains and losses in respect of equity instruments held for trading will be recognised through the income statement For other equity instruments, it will be possible to make an irrevocable election at initial recognition to recognise realised and unrealised fair value gains and losses directly in equity through the statement of comprehensive income It will not be possible to recycle gains and losses in respect of such investments to the income statement although dividend income associated with such instruments will be recognised in the income statement rather than being taken directly to equity Adoption of this standard, which has not yet been endorsed by the EU, is not expected to have any impact on the financial results or position of the Company

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

31 Restatement of comparatives

The following table sets out the balance sheets as at 31 December 2008 and 1 January 2008 and the income statement for the year ended 31 December 2008 as presented in the 2008 financial statements of the Company with reclassifications made to present these statements on a basis consistent with the presentation practices adopted by Lloyds Banking Group plc

BALANCE SHEET AS AT 31 DECEMBER 2008

	As previously presented £m	Balance sheet reclassifications £m	Restated £m
ASSETS			
Deferred tax asset (Note 3)	231 7	204 1	435 8
Deferred costs	275 9	-	275 9
Investment properties	106 1	-	106 1
Investment in Group undertakings and participating interests (Note 1)	1,622 6	(1,622 6)	-
Reinsurers' share of insurance contract liabilities	100 1	-	100 1
Prepayments (Note 2)	23 6	(23 6)	-
Current tax receivable	19 0	-	19 0
Financial assets			
Derivative financial instruments	198 8	-	198 8
Loans and receivables (Note 2)		85 6	85 6
Insurance receivables (Note 2)	13 9	(13 9)	-
Investments at FV through income (Notes 1 and 4)	-	10,953 7	10,953 7
Equity investments (Note 4)	4 057 1	(4 057 1)	-
Debt investments (Note 4)	5,158 2	(5,158 2)	-
Cash and cash equivalents (Note 5)	66 3	38 8	105 1
Other assets (Note 2)	48 1	(48 1)	-
Total assets	11,921 4	358 7	12,280 1
EQUITY AND LIABILITIES			
Capital & reserves attributable to Company's equity holders			
Issued share capital	(360 0)	-	(360 0)
Retained earnings	(578 9)	-	(578 9)
Total equity	(938 9)	-	(938 9)
LIABILITIES			
Insurance contracts liabilities	(10,721 3)	-	(10,721 3)
Deferred tax liability (Note 3)	-	(204 1)	(204 1)
Current tax payable	(24 4)	-	(24 4)
Financial liabilities			
Derivative liabilities	(58 7)	-	(58 7)
Investment contracts liabilities	(9 9)	-	(9 9)
Other insurance financial liabilities (Note 6)	(105 6)	105 6	-
Accruals and deferred income	(4 1)	-	(4 1)
Other liabilities (Notes 5 and 6)	(58 5)	(260 2)	(318 7)
Total liabilities	(10,982 5)	(358 7)	(11,341 2)
Total liabilities and equity	(11,921 4)	(358 7)	(12,280 1)

BALANCE SHEET AS AT 1 JANUARY 2008

	As previously presented £m	Balance sheet reclassifications £m	Restated £m
ASSETS			
Deferred tax asset (Note 3)	-	122 3	122 3
Deferred costs	284 2	-	284 2
Investment properties	129 5	-	129 5
Investment in Group undertakings and participating interests (Note 1)	1,957 3	(1,957 3)	-
Reinsurers' share of insurance contract liabilities	258 8	-	258 8
Prepayments (Note 2)	60 3	(60 3)	-
Current tax receivable	-	-	-
Financial assets			
Derivative financial instruments	68 8	-	68 8
Loans and receivables (Note 2)		150 8	150 8
Insurance receivables (Note 2)	3 8	(3 8)	-
Investments at FV through income (Notes 1 and 4)		14,402 1	14,402 1
Equity investments (Note 4)	7,050 0	(7,050 0)	-
Debt investments (Note 4)	5,394 8	(5,394 8)	-
Cash and cash equivalents (Note 5)	59 4	26 4	85 8
Other assets (Note 2)	86 7	(86 7)	-
Total assets	15,353 6	148 7	15,502 3
EQUITY AND LIABILITIES			
Capital & reserves attributable to Company's equity holders			
Issued share capital	(360 0)	-	(360 0)
Retained earnings	(238 8)	-	(238 8)
Total equity	(598 8)	-	(598 8)
LIABILITIES			
Insurance contracts liabilities	(11,995 0)	-	(11,995 0)
Deferred tax liability (Note 3)	(96 2)	(122 3)	(218 5)
Current tax payable	(19 7)		(19 7)
Financial liabilities			-
Derivative liabilities	(3 8)	-	(3 8)
Investment contracts liabilities	(2,447 6)	-	(2,447 6)
Other insurance financial liabilities (Note 6)	(130 8)	130 8	-
Accruals and deferred income	(4 6)		(4 6)
Other liabilities (Notes 5 and 6)	(57 1)	(157 2)	(214 3)
Total liabilities	(14,754 8)	(148 7)	(14 903 5)
Total liabilities and equity	(15,353 6)	(148 7)	(15,502 3)

The significant balance sheet reclassifications (none of which require re-measurement of an asset or liability) are in relation to

Note 1 – The reclassification of Investments in subsidiaries as Investments at fair value through income
Note 2 – The reclassification of accrued interest, insurance receivables and other receivables to loans and receivables
Note 3 – The reclassification of tax balances to show gross assets and liabilities
Note 4 – The reclassification of Debt and Equity instruments to Investments at FV through income on the face of the balance sheet Within this balance there is also the reclassification of £3,255m of UCITS OEIC funds from debt to equity
Note 5 – The reclassification of the liability associated with receiving collateral assets
Note 6 – Other insurance financial liabilities re-classed to Other liabilities

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009 (Continued)

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2008

	As previously presented £m	Balance sheet reclassifications £m	Restated £m
Revenue			
Gross premiums written (Note 1)	2,285 7	(4 6)	2,281 1
Premiums ceded to reinsurers	20 6	-	20 6
Premiums written net of reinsurance	2,306 3	(4 6)	2,301 7
Fee and commission income (Note 1)	3 5	4 6	8 1
Investment income	512 3	-	512 3
Net realised losses on assets and liabilities at fair value though income	(231 2)	-	(231 2)
Net fair value gains/(losses) on assets and liabilities at fair value through income	(1,969 0)	-	(1,969 0)
Total revenue	621 9	-	621 9
Expenses			
Gross claims and benefits paid	2,078 7	-	2,078 7
Claims recoveries from reinsurers	(72 4)	-	(72 4)
	2,006 3	-	2,006 3
Change in insurance contract liabilities	(1,273 7)	-	(1,273 7)
Change in investment contract liabilities	(529 7)	-	(529 7)
Change in reinsurers' share of liabilities	158 7	-	158 7
	(1,644 7)	-	(1,644 7)
Operating expenses (Notes 2 and 3)	-	195 3	195 3
Other operating and administration expenses (Note 3)	97 3	(97 3)	-
Fee and commission expenses (Note 3)	136 8	(136 8)	-
Expenses for asset management services received (Note 2)	-	38 8	38 8
Finance costs	4 8	-	4 8
	238 9	-	238 9
Total expenses	600 5	-	600 5
Profit before tax	21 4	-	21 4
Taxation (charge)/credit	318 7	-	318 7
Profit for the year	340 1		340 1

Note 1 – The reclassification of deferred income reserve movement from Premiums to Fee and Commission Income
Note 2 – The reclassification of Investment Management Fees from Other operating and administration expenses to Expenses for asset management services received
Note 3 – The reclassification of Other operating and administration expenses and Fee and commission expenses to Operating Expenses