

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2007

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Registered Number 3196171

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

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CLERICAL MEDICAL INVESTMENT GROUP LIMITED

DIRECTORS' AND COMPANY INFORMATION

CHIEF EXECUTIVE J Dawson

MANAGING DIRECTOR R A Devey

OTHER DIRECTORS M Christophers*
S J Colsell
B J Duffin*
P N C Gale*
T A Leonard
A M Peck*

** Non Executive Director*

SECRETARY P J Veale

REGISTERED OFFICE 33 Old Broad Street
London
EC2N 1HZ

PRINCIPAL PLACES OF BUSINESS	<u>Bristol Head Office</u>	<u>Clevedon Head Office</u>	<u>Aylesbury Office</u>
	10 Canons Way Bristol BS1 5LF	Tickenham Road Clevedon BS21 6BD	Walton Street Aylesbury HP21 7QW

AUDITORS KPMG Audit Plc
8 Salisbury Square
London
EC4Y 8BB

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

DIRECTORS' REPORT

The Directors present their Report and the audited Financial Statements for the year ended 31 December 2007

BUSINESS REVIEW

The Company, which is authorised by the Financial Services Authority and is a member of the Association of British Insurers, is a wholly owned subsidiary of HBOS Financial Services Limited and the ultimate parent undertaking is HBOS plc

The Company's principal activity is the transaction of long term insurance and investment business and associated investment activities including non profit, with profit and unit linked business in the United Kingdom and abroad. Throughout the year the Company made its life and pension products available principally through independent financial advisers. The Company also reassures business with and from fellow subsidiary undertakings of the ultimate parent undertaking and with and from insurance entities external to the Group. This includes the majority of the pension linked business that is reassured to the Company's subsidiary Clerical Medical Managed Funds Limited.

RISK MANAGEMENT

The key risks of the Company are considered to be market risk (currency, interest rate and price), credit and liquidity risk, insurance risk and operational risk.

Detailed analysis of the risks and their management is included within the notes to the financial statements.

The risks associated with the activities of the Company are overseen by the Risk Control Committee of the Insurance & Investment Division of HBOS plc. The Committee, which is chaired by a Director of HBOS plc, reviews all risk and compliance issues affecting the Company, as well as the other wholly owned companies within the Insurance & Investment Division.

In addition to the Risk Control Committee, there are a number of other committees responsible for different aspects of corporate governance of HBOS plc and its major subsidiaries. Further details of these committees and compliance with the Combined Code on corporate governance are included in the HBOS plc annual report and accounts.

Further, there is a Long Term Business Governance Committee, the role of which is to balance the interests of policyholders and shareholders.

PERFORMANCE

The profit for the year after taxation was £492.3 million (2006 £96.3 million profit), and profit before taxation £379.3 million (2006 £5.6 million loss). A dividend of £204m (2006 nil) was paid during the year.

The new business sold during the year amounted to £424.9 million (2006 £452.0 million), on an Annual Premium Equivalent (APE) basis, which is calculated as annualised regular premium new business plus one tenth of single premium new business. Total insurance premiums recognised in the Income Statement were £642.5 million (2006 £531.4 million) and total investment premiums deposited accounted were £2,365.4 million (2006 £2,455.0 million).

The Funds Under Management are approximately £19 billion (2006 £21 billion).

The Directors believe that the Company currently has adequate capital resources, has had throughout the year and will continue to do so in the foreseeable future.

The Directors have chosen Key Performance Indicators they consider appropriate to the principal activity of the Company.

FUTURE DEVELOPMENTS

A business plan is produced for the operations of the HBOS Financial Services group of companies, of which the Company is part. Progress against this is monitored regularly by the Board. The Company expects to continue to transact long term insurance and investment business and associated investment activities for the foreseeable future.

The Company has no employees. All staff providing services to the Company are employed by HBOS plc.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

POST BALANCE SHEET EVENTS

No significant events affecting the company have occurred since 31 December 2007

GOING CONCERN

The Directors are satisfied that the Company has adequate resources to continue in business for the foreseeable future and consequently the going concern basis continues to be appropriate in preparing the accounts

AUDIT INFORMATION

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they each are aware, there is no relevant audit information of which the Company's auditors are unaware, and each Director has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information

ULTIMATE HOLDING COMPANY

HBOS plc is the ultimate parent undertaking of Clerical Medical Investment Group Limited and heads the largest group into which the accounts of the Company are consolidated. The consolidated accounts of HBOS plc may be obtained from its head office at The Mound, Edinburgh EH1 1YZ

SUPPLIER PAYMENT POLICY

The Company's suppliers are paid through HBOS plc's centralised Accounts Payable department

For the forthcoming period HBOS plc's policy for the payment of suppliers will be as follows

- Payment terms will be agreed at the start of the relationship with the supplier and will only be changed by agreement,
- Standard payment terms to suppliers of goods and services will be 30 days from receipt of a correct invoice for satisfactory goods or services which have been ordered and received unless other terms are agreed in a contract,
- Payment will be made in accordance with the agreed terms or in accordance with the law if no agreement has been made, and
- Suppliers will be advised without delay when an invoice is contested and disputes will be settled as quickly as possible

HBOS plc complies with the Better Payment Practice Code. Information regarding this Code and its purpose can be obtained from the Better Payment Practice Group's website at www.payontime.co.uk

HBOS plc had trade creditors outstanding at 31 December 2007 representing 20 days of purchases

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

DIRECTORS

The Directors who served during the year were as follows

SJ Colsell*	
M Christophers	
J Dawson	
R A Devey*	
D G R Ferguson	<i>Resigned 31 December 2007</i>
T A Leonard	
P McNamara	<i>Resigned 30 June 2007</i>
R J H Milne	<i>Resigned 30 June 2007</i>
M R N Moore	<i>Resigned 31 December 2007</i>
K A Nealon	<i>Resigned 31 December 2007</i>
M P Smith	<i>Resigned 31 December 2007</i>
T Woolgrove	<i>Resigned 30 June 2007</i>

The following Directors were appointed after 31 December 2007

B J Duffin*	<i>Appointed 24 January 2008</i>
P N C Gale*	<i>Appointed 24 January 2008</i>
A M Peck*	<i>Appointed 24 January 2008</i>

* Member of the Long Term Business Governance Committee

AUDITOR

KPMG Audit Plc, having expressed their willingness to do so, will continue in office as auditor

ANNUAL GENERAL MEETING

Pursuant to a Resolution passed by the members, the Company has elected to dispense with the holding of Annual General Meetings, of laying accounts before the Company in General Meeting and with the obligation to reappoint auditors annually

By order of the Board



P J VEALE
Secretary

33 Old Broad Street
London
EC2N 1HZ

27 March 2008

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS

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 IFRSs as adopted by the EU.

The Financial Statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the company and performance for that period, the Companies Act 1985 provides in relation to such Financial Statements that references in the relevant part of that Act to Financial Statements giving a true and fair view are references to their achieving a fair presentation.

In preparing these Financial Statements, the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and estimates that are reasonable and prudent,
- state whether they have been prepared in accordance with IFRSs as adopted by the EU, and
- prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its Financial Statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF CLERICAL MEDICAL INVESTMENT GROUP LIMITED

We have audited the financial statements of Clerical Medical Investment Group Limited for the year ended 31 December 2007, which comprise the Income Statement, the Balance Sheet, the Statement of Recognised Income and Expense, the Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 7.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

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

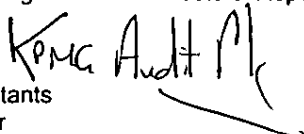
We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity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

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Company's affairs as at 31 December 2007 and of its profit for the year then ended, and
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc
Chartered Accountants
Registered Auditor



8 Salisbury Square
London
EC4Y 8BB

27 March 2008

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2007

	Note	2007 £m	2006 £m
TOTAL REVENUE		1,981 0	2,500 9
Net insurance revenue	4	480 3	305 7
Gross earned premiums on insurance contracts		642 5	531 4
Less reinsurers' share of gross earned premiums on insurance contracts		(162.2)	(225 7)
Other revenue		1,500 7	2,195 2
Investment income	5	1,158 1	947 9
Finance income	8	43 1	32 1
Net realised gains recorded in the income statement		769 1	1,127 0
Fee and commission income		86 2	77 5
Net fair value (losses) / gains recorded in the income statement	6	(1,006.8)	10 7
Income from shares in group undertakings		451 0	-
TOTAL EXPENSES		(1,601.7)	(2,506 5)
Net insurance claims and benefits	7	(683.8)	(1,310 0)
Gross insurance contracts claims and benefits paid		(898.7)	(980 3)
Less reinsurers' share of gross insurance contracts		202 4	209 5
Gross change in insurance contracts		(119.8)	(615 8)
Less reinsurers' share of gross change in insurance contracts		132 3	76 6
Other expenses		(917.9)	(1,196 5)
Change in unallocated surplus		72 0	(575 0)
Net change in investment contracts		(387.5)	79 8
Finance costs	8	(89.2)	(82 0)
Fee and commission expenses		(79.2)	(118 6)
Other operating and administration expenses	9	(434.0)	(500 7)
Profit / (loss) before taxation		379 3	(5 6)
Total income tax credit	10	113 0	101 9
Taxation attributable to policyholder returns		74 6	(59 6)
Taxation attributable to shareholders		38 4	161 5
Profit after taxation		492 3	96 3

The accounting policies and notes set out on pages 13 to 56 are an integral part of the financial statements

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

BALANCE SHEET AS AT 31 DECEMBER 2007

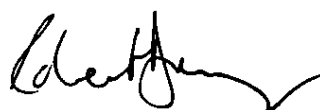
	Note	2007 £m	2006 £m
ASSETS			
Intangible assets	11	294 0	378 2
Property and equipment	12	161 4	202 5
Investment properties	13	2,274 1	2,764 2
Deferred costs	14	413 1	315 1
Investment in Group undertakings and participating interests	15	6,159 2	6,284 9
Reinsurance assets	16	11,097 1	10,352 9
Prepayments and accrued income	17	36 7	15 3
Current tax receivable	26	105 7	243 5
Financial assets			
Financial assets at fair value through income statement			
Derivative assets	18	101 5	126 2
Equity investments	19	5,962 9	5,766 9
Debt investments	19	5,775 6	6,732 9
Insurance receivables	20	49 5	56 7
Other receivables	20	558 0	743 2
Cash and cash equivalents	21	267 8	150 4
Total assets		33,256 6	34,132 9
LIABILITIES AND EQUITY			
LIABILITIES			
Insurance contract liabilities	22, 25	(8,012.1)	(8,502 2)
Unallocated surplus	23	(1,497 4)	(1,569 4)
Deferred tax liability	26	(389 0)	(565 1)
Financial liabilities			
Derivative liabilities	18	(37 9)	(22 5)
Investment contract liabilities	24, 25	(19,625 5)	(20,121 5)
Borrowings	27	(51 4)	(41 1)
Other insurance financial liabilities	28	(99 1)	(89 5)
Accruals and deferred income	29	(28 2)	(19 3)
Trade and other liabilities	30	(224 4)	(266 8)
Subordinated liabilities	31	(1,030 8)	(965 6)
Total liabilities		(30,995 8)	(32,163 0)
CAPITAL & RESERVES ATTRIBUTABLE TO COMPANY'S EQUITY HOLDERS			
Issued share capital	32	(1,629 0)	(1,629 0)
Share premium account	32	(1 0)	(1 0)
Other reserves	32	(2 6)	(611 7)
Retained earnings		(628 2)	271 8
Total equity		(2,260 8)	(1,969 9)
Total liabilities and equity		(33,256 6)	(34,132 9)

The accounting policies and notes set out on pages 13 to 56 are an integral part of the financial statements

These accounts were approved and authorised for issue by the Board of Directors on 27 March 2008 and were signed on its behalf by



T A LEONARD
DIRECTOR



R A DEVEY
DIRECTOR

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

STATEMENT OF RECOGNISED INCOME AND EXPENSE FOR THE YEAR ENDED 31 DECEMBER 2007

	2007 £m	2006 £m
Foreign exchange translation	3.7	-
Tax impact of foreign exchange translation	(1.1)	-
Net income recognised directly in equity	2.6	-
Profit for the year	492.3	96.3
Total recognised income and expense	494.9	96.3

The accounting policies and notes set out on pages 13 to 56 are an integral part of the financial statements

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2007

	Note	2007 £m	2006 £m
CASH FLOW FROM OPERATING ACTIVITIES			
Profit / (loss) before taxation		379 3	(5 6)
Exclude Dividends received from group undertaking		(451 0)	-
Depreciation and amortisation		125 3	36 1
Increase in deferred costs		(98 0)	(83 9)
Increase in deferred income		8 9	8 3
Decrease in insurance contract liabilities		(480 5)	(547 4)
(Decrease) / increase in unallocated surplus		(72 0)	575 0
Decrease in investment contract liabilities		(496 0)	(158 9)
Increase in reinsurance assets		(744 2)	(1,309 4)
Decrease / (increase) in investment property		490 1	(195 4)
Increase in equity investments		(196 0)	(621 6)
Decrease in debt investments		957 3	679 3
Net decrease in derivative investments		40 1	16 1
Net decrease in Investment in Group undertakings and participating interests		125 7	1,460 6
Net decrease in other operating assets and liabilities		148 3	220 9
Taxation received / (paid)		68 6	(27 5)
Net cash (outflow) / inflow from operating activities		(194 1)	46 6
CASH FLOW FROM INVESTING ACTIVITIES			
Loans made to subsidiary undertakings		-	(60 0)
Loans repaid from subsidiary undertakings		54 2	-
Dividends received from group undertaking		451 0	-
Net cash inflow / (outflow) from investing activities		505 2	(60 0)
CASH FLOW FROM FINANCING ACTIVITIES			
Increase in overdraft		10.3	41 1
Equity dividends paid		(204.0)	-
Net cash (outflow) / inflow from financing activities		(193 7)	41 1
Net (decrease) / increase in cash and cash equivalents		117 4	27 7
Cash and cash equivalents at the beginning of the year	21	150 4	122 7
Cash and cash equivalents at 31 December	21	267 8	150 4

The accounting policies and notes set out on pages 13 to 56 are an integral part of the financial statements

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007

1 Accounting policies

1.1 Company and its operations

Clerical Medical Investment Group Limited ("the Company") is a limited liability company incorporated in the United Kingdom. The principal activity of the Company is the undertaking of ordinary long term insurance business in the UK and overseas. The Company offers a wide range of life insurance products such as annuities, pensions, whole life, term life and investment type products.

The Company is exempt by virtue of s228 of the Companies Act 1985 and IAS 27 "Consolidated and Separate Financial Statements" from the requirement to prepare group financial statements. These financial statements present information about the Company as an individual undertaking and not about its group.

The financial statements for the year ended 31 December 2007 were authorised for issue in accordance with a resolution of the directors on 27 March 2008.

1.2 Basis of preparation

The financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS") as endorsed by the European Union, interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") of the International Accounting Standards Board ("IASB"), those parts of the Companies Act 1985 applicable to companies reporting under IFRS and under the historical cost convention model, as modified by the revaluation of investment properties, owner occupied property, investment securities and derivative assets and liabilities. In accordance with IFRS 4 "Insurance contracts", the Company has applied UK GAAP (including, in particular, the requirements of FRS 27) for its long term insurance contracts. The financial statements are also prepared on a going concern basis.

In preparing these financial statements, the company has adopted IFRS 7 *Financial Instruments: Disclosures* and IAS 1 *Presentation of Financial Statements – Capital Disclosures*. The adoption of IFRS 7 and the amendment to IAS 1 impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of the company. In accordance with the transitional requirements of the standards, the company has provided full comparative information.

1.3 Use of estimates, assumptions and judgments

The preparation of the financial statements necessitates the use of estimates, assumptions and judgments. These estimates and assumptions affect the reported amounts of assets and liabilities, contingent liabilities at the balance sheet date as well as affecting the reported income and expenses for the year. Although, the estimates are based on management's best knowledge and judgment of current facts as at the balance sheet date, the actual outcome may differ from these estimates, possibly significantly.

1.4 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. These accounting policies are those which involve the most complex or subjective decisions or assessments, and relate to insurance and investment liabilities, deferred acquisition costs and the ascertainment of fair values of reinsurance assets, financial assets, liabilities, derivative financial instruments and of investment properties and the determination of impairment losses. In each case, the determination of these is fundamental to the financial results and position and requires management to make complex judgments based on information and financial data that may change in future periods.

Since these involve the use of assumptions and subjective judgments as to future events and are subject to change, the use of different assumptions or data could produce materially different results.

The significant accounting policies adopted in the preparation of the financial statements are set out below.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

1 4 Summary of significant accounting policies (continued)

(a) Product classification

The Company has classified its Long Term Assurance business in accordance with IFRS 4 "Insurance Contracts" as follows

- Insurance contracts – all contracts containing significant insurance risk,
- Investment contracts with discretionary participating features ("DPF") – contracts that do not contain significant insurance risk but contain discretionary participating features which are with-profits contracts,
- Investment contracts – contracts that have neither significant insurance risk nor a discretionary participating feature

Insurance contracts and investment contracts with discretionary participating features

Liabilities on insurance contracts and investment contracts with DPF relating to both traditional and unitised with-profit contracts are calculated with reference to the expected pay out using realistic and where applicable market consistent assumptions in accordance with FRS27. In the case of the former, premiums are recognised as revenue when due from policyholders and claims payable recorded as claims when notified. In the case of the latter, deposits and withdrawals are accounted for directly in the balance sheet as adjustments to the investment contract liability.

Insurance contract liabilities for contracts without DPF are calculated in accordance with the General Prudential Sourcebook ("GENPRU") and the Prudential Sourcebook for Insurers ("INSPRU") as amended by PS06/14 for term insurance business issued by the Financial Services Authority. These are adjusted to remove the closure provisions and certain other reserves required under GENPRU/INSPRU rules. Premiums are recognised as revenue when due from policyholders. Claims are recognised when notified or due.

The accounting policies set out above in respect of the measurement of the policyholder liabilities include liability adequacy testing that meet or exceed the requirements of IFRS 4. This testing considers estimates of all contractual cash flows, related cash flows such as claims handling costs, as well as cash flows resulting from embedded options and guarantees.

Investment contracts

The Company's investment contracts are predominantly unit-linked. The liability is measured at fair value, which is estimated using a valuation technique. In accordance with this technique the liability is established as the bid value of assets held to match the liability, less an allowance in relation to deductions made to the liability for tax on unrealised chargeable gains relating to matching assets.

Deposits and withdrawals are accounted for as adjustments to the investment contract liability.

(b) Revenue recognition

Premium income

Gross premiums written are accounted for on a cash basis in respect of single premium business and pensions business not subject to contractual regular premiums. For all other classes of business, gross premiums written are accounted for in the year in which they are due for payment. Outward reinsurance premiums are accounted for when the related gross premiums written are recognised. Gross premiums written exclude any taxes or duties based on premiums.

Investment income

All income from listed stocks and shares is included in the accounts when the security becomes ex-dividend. Other investment income, including interest income from fixed interest investments and rent, is accrued up to the balance sheet date. Realised gains and losses on investments are calculated as the difference between net sales proceeds and the original cost. Rental income from investment properties is also recognised in investment income. It is recognised in the period it is due.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

1.4 Summary of significant accounting policies (continued)

Realised gains and losses

Realised gains and losses on the sale of property and equipment is the difference between net sales proceeds and the net realisable value. Realised gains and losses are recognised in the income statement when the sale transaction occurs.

Fee and commission income

Revenue arising from services rendered is recognised in the accounting period in which the services are rendered. Fees received for services to be provided in future periods are deferred and recognised in the income statement as the service is provided over the term of the contract. Initiation and other front end fees are also deferred and recognised over the term of the contract. Regular fees charged at the end of the period in which the related service is performed, are accrued as a receivable.

(c) Expense recognition

Claims

Life insurance business claims reflect the cost of all claims incurred during the year, including claims handling costs. Death claims and surrenders are recorded on the basis of notifications received. Maturities and annuity payments are recorded when due.

Interest paid

Interest paid is recorded in the period in which it is incurred.

Commission

Commission payable is accounted for on the same basis as the corresponding premiums, except for commission payable under indemnity terms, which is charged when paid.

(d) Intangible assets

Costs associated with the development of software for internal use, are capitalised only if the software is considered to be at the required standard technically for sale or use on completion and the Company has both the intent and sufficient resources to complete the development. Additional costs are capitalised only if the asset can be reliably measured, will generate future economic benefits and there is an ability to use or sell the asset. The cost is amortised over the expected useful life of the intangible asset on a straight line basis. The useful life is set at 5 years, which is reassessed annually.

Investment contracts acquired in business combinations and portfolio transfers are measured at fair value at the time of acquisition. The resulting asset is referred to as purchased value of in-force investment contracts ('PVIF') and is amortised over the estimated lives of the contracts on a systematic basis as margins emerge. PVIF is assessed for impairment at each reporting date. Where impairment exists, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement. The amortisation charge is then adjusted to reflect the revised carrying amount.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

1 4 Summary of significant accounting policies (continued)

(e) Property and equipment

All equipment is stated at cost less accumulated depreciation and any impairment in value. Depreciation is provided on a straight line basis over the estimated useful lives of the individual significant components of equipment until the assets are written down to nil. The useful lives are generally estimated as being between two and five years.

Owner occupied properties are valued at least every three years. The Directors' estimated open market value is used for any properties not valued at the balance sheet date.

Property under construction is valued at each balance sheet date by persons who are members of the Royal Institute of Chartered Surveyors. The valuations are conducted in accordance with the RICS Statement of Asset Valuation and Guidance Notes.

(f) Investment property

Property held for long term rental yields and for capital appreciation is classified as investment property. Investment properties are initially measured at cost. Subsequently, at each balance sheet date such properties are carried at fair value. In all cases, valuations are carried out by persons who are members of the Royal Institute of Chartered Surveyors. The valuations are conducted in accordance with the RICS Statement of Asset Valuation and Guidance Notes.

Investment properties are derecognised when either their use changes or they have been disposed of or when the investment property is permanently withdrawn from use and no future benefit is expected from its disposal. Gains or losses arising from changes in the fair values of investment properties are included in the income statement in the period in which they arise.

If an item of property and equipment becomes an investment property because its use has changed, any difference arising between the net book value and the fair value of the item at the date of transfer is recognised as a fair value gain in the income statement and is subsequently treated under the normal policies for investment properties.

(g) Deferred costs

Commission and other acquisition costs incurred during the financial period that vary with and are related to securing new insurance contracts and/or renewing of existing insurance contracts, but which relate to subsequent financial periods, are deferred to the extent that they are recoverable out of future revenue margins. Deferred acquisition costs ("DAC") are capitalised and are amortised over the life of the contract. Commission in relation to securing investment contracts without DPF is likewise capitalised as deferred origination costs ("DOC") and amortised as the related revenue is recognised. All other costs are recognised as an expense when incurred.

An impairment review is performed by category of business at each reporting date. Where there is any indication of impairment the carrying value is written down to the recoverable amount.

(h) Reinsurance contracts

Only contracts that give rise to a significant transfer of insurance risk are accounted for as reinsurance. Amounts recoverable under such contracts are recognised in the same period as the related claims and premiums. Substantially all the reinsurance is with Group undertakings.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

1.4 Summary of significant accounting policies (continued)

(i) Fair values of financial assets and liabilities

Fair value determinations for financial assets and financial liabilities are based on, if readily available, either bid market prices at the close of business on the balance sheet date for listed instruments, or broker or dealer price quotations, or by reference to current market values of another instrument which is substantially the same. If prices are not readily available, the fair value is based on either internal valuation models or management's estimate of amounts that could be realised under current market conditions, assuming an orderly liquidation over a reasonable period of time. Certain financial instruments, including financial derivative instruments, are valued using pricing models that consider, among other factors, contractual and market prices, correlation, time value of money, credit risk, yield curve volatility factors and / or prepayment rates of the underlying positions. The use of different pricing models and assumptions could produce materially different estimates of fair values.

(j) Derivative financial instruments

Derivatives are initially recognised at fair value on the date the contract is entered into. Where the fair value of a derivative is positive, it is carried as a derivative asset and where negative as a derivative liability. The gain or loss on remeasurement to fair value at the balance sheet date is taken to net trading income except for the interest accrual element relating to derivatives used for economic hedging purposes that do not qualify for hedge accounting treatment which is taken to net interest income, insurance and investment related derivatives which are taken to net investment income related to insurance and investment business or when cash flow hedge accounting is employed.

Fair values are obtained from quoted prices prevailing in active markets. For those transactions where there are no readily available quoted prices, which predominantly relate to over the counter transactions, market values are determined by reference to valuation models, including discounted cash flow and options pricing models as appropriate.

Hedge accounting allows one financial instrument, generally a derivative such as a swap, to be designated as a hedge of another financial instrument such as a loan or deposit or a portfolio of the same. At inception of the hedge relationship formal documentation must be drawn up specifying the hedging strategy, the component transactions and the methodology that will be used to measure effectiveness.

Monitoring of hedge effectiveness is undertaken on an ongoing basis. A hedge is regarded as effective if the change in fair value or cash flows of the hedge instrument and the hedged item are negatively correlated within a range of 80% to 125% either for the period since effectiveness was last tested or cumulatively since inception.

The Company uses one hedge accounting method. Fair value hedge accounting offsets the change in the fair value of the hedging instrument against the change in the fair value of the hedged item in respect of the risk being hedged. The hedged item is adjusted for the fair value of the risk being hedged irrespective of its financial instrument classification. These changes in fair value are recognised in the income statement through net trading income. Adjustments made to the carrying amount of the hedged item for fair value hedges will be amortised on an effective interest rate basis over the remaining expected life in line with the presentation of the underlying hedged item. If the hedge is highly effective the net impact on the income statement is minimised.

The Company does not separate embedded derivatives that meet the definition of an insurance contract.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

14 Summary of significant accounting policies (continued)

(k) Financial assets

All financial assets are initially recognised at fair value at the date of acquisition. Subsequently all financial assets are valued at fair value through the income statement. A financial asset is derecognised when the contractual right to receive cash flows expires or when the asset is transferred.

Financial assets at fair value through the income statement have two sub categories, financial assets held for trading and those designated at fair value through the income statement at inception.

The carrying values of all financial assets are 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 market prices and expected net selling prices.

(l) Insurance receivables

Insurance receivables are recognised when due and measured at fair value.

(m) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand and short term deposits with an original maturity of three months or less at the date of placement, free of any encumbrances.

(n) Long term assurance business assets

Assets held and managed in support of the long term assurance liabilities are designated at fair value through the income statement.

(o) Unallocated surplus

The unallocated surplus is accounted for as permitted by IFRS 4. The carrying value of the unallocated surplus is determined as the residual assets of the with-profit fund after providing for traditional and unitised with-profit liabilities in accordance with the policies described above.

(p) Income taxes

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement, except to the extent that income taxes relating to items recognised directly in equity are recognised in equity.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantially enacted at the balance sheet date, together with adjustments to tax payable in respect of prior years.

Deferred tax is provided in full using the liability method on all temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the balance sheet date. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

Deferred 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 tax assets are reviewed at each balance sheet 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 tax asset to be utilised.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

14 Summary of significant accounting policies (continued)

(p) Income taxes (continued)

The income tax charge is analysed between tax on equity holders' returns and the balance which represents the tax in respect of policyholders' returns. The income tax charge in respect of policyholders' returns / equity holders' returns reflects the movement in current and deferred taxes recognised in respect of those items of income, gains and expenses which relate to the benefits of policyholders / equity holders respectively.

(q) Borrowings

All borrowings and loans taken up are initially recognised at cost, being the fair value of the consideration received, net of issue costs associated with such borrowings or loans.

After initial recognition, interest bearing borrowings and loans are subsequently measured at amortised cost, using the effective interest rate method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

(r) Provisions

Provisions are recognised when the Company has a present legal or constructive obligation, as a result of a past event, which is probable and will result in an outflow of resources, and which can be measured reliably. 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 for the time value of money and, where appropriate, the risks specific to the liability.

The Company recognises provisions for onerous contracts when the expected benefits to be derived from the contracts are less than the unavoidable costs of meeting the obligations under the contracts.

(s) Group undertakings

Investments in Group undertakings are valued at cost.

Where the Company owns a majority holding in a Collective Investment Scheme, held in support of the long term assurance liabilities, the holding has been classified as a group undertaking and fair valued at the balance sheet date with all gains and losses being accounted for through the income statement.

As the Company is a wholly owned subsidiary undertaking of a company registered in England and Wales, group financial statements are not prepared.

(t) Off-setting financial instruments

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

(u) Current, non current disclosure

For each asset and liability line item that combines amounts expected to be recovered or settled within twelve months after the balance sheet date, those items will be classified as current at the balance sheet date. Amounts expected to be recovered or settled greater than twelve months after the balance sheet date are classified as non current.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

14 Summary of significant accounting policies (continued)

(v) Foreign currency

Transactions in foreign currencies are translated using the rate of exchange ruling at the date of the transaction. Assets and liabilities denominated in foreign currencies are translated into sterling using the rate of exchange ruling at the balance sheet date and the gains and losses on translation are included in the income statement.

The results and financial position of all the Company's entities that have a functional currency different from sterling are translated into sterling as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of the balance sheet,
- income and expenses are translated at the average exchange rates for the period (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions).

All resulting exchange differences are recognised as a separate component of other reserves within equity.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

2 Use of estimates, assumptions and judgments

The Company makes estimates and assumptions that affect the reported amounts 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.

(a) Claims liability arising from insurance contracts

The estimation of the ultimate liability arising from claims made under insurance contracts is the Company's most critical accounting estimate. There are several sources of uncertainty that need to be considered in the estimation of the liability that the Company will ultimately pay for those claims.

For life insurance contracts, estimates are made as to the expected number of deaths for each of the years in which the Company is exposed to risk. The Company bases these estimates on standard industry and national mortality tables that reflect historical mortality experience, adjusted where appropriate to reflect the Company's unique risk exposure. The estimated number of deaths determines the value of possible future benefits to be paid out, which will be factored into ensuring sufficient cover by reserves, which in return is monitored against current and future premiums. For those contracts that insure risk to longevity, prudent allowance is made for expected future mortality improvements, but epidemic, as well as wide ranging changes to life style, could result in significant changes to the expected future mortality exposure. All of these result in even more uncertainty in estimating the ultimate liability.

Estimates are also made as to future investment income arising from the assets backing life insurance contracts. These estimates are based on current market returns as well as expectations about future economic and financial developments.

Estimates for future deaths, voluntary terminations, investment returns and administration expenses are used to calculate the liability over the term of the contract. At each reporting date, these estimates are reassessed for adequacy and changes will be reflected in adjustments to the liability.

Stochastic valuation techniques are used to assess the value of options and guarantees in the with-profit funds.

(b) Investment contracts fair value

The Company issues investment contracts that are designated at fair value through the income statement. For the financial instruments that are not quoted in active markets, their fair values are determined by using valuation techniques. Such techniques (which are internally generated valuation models), are validated and periodically reviewed by an independently qualified person. A variety of factors are considered in these valuation techniques, including time value of money, credit risk and volatility factors. Changes in assumptions about these factors could have a material impact on the reported fair values of these financial instruments.

(c) Fair value of financial assets at fair value through the income statement

The fair value of quoted investments is their quoted bid price at the balance sheet date. If the market for a financial asset is not active, the Company establishes fair values by using valuation techniques. These include the use of recent arm's length market transactions, references to another instrument that is substantially the same, discounted cash flow analysis and option pricing models.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

3. Transfer of Insurance Business

On 25 November 2005 the High Court made an order sanctioning a scheme to transfer insurance business under Part VII of the Financial Services and Markets Act 2000. The transfer took place at 11 59 pm on 26 May 2006 ("the Effective Time") and transferred 100% of Halifax Life Limited's With-Profits Bonus Bond business to the Company, together with associated deferred assets and liabilities. This business had previously been fully reassured with the Company. The value of the associated deferred acquisition costs transferred was £26 0m, with a related £6 6m deferred tax liability. This was reflected as an increase in investment income during 2006.

4. Net insurance revenue

	2007 £m	2006 £m
With DPF	151.3	147.9
Without DPF	491.2	383.5
Gross insurance contract premium revenue	642.5	531.4
With DPF	-	-
Without DPF	(162.2)	(225.7)
Reinsurers' share of insurance contract premium revenue	(162.2)	(225.7)
With DPF	151.3	147.9
Without DPF	329.0	157.8
Total net insurance premium revenue	480.3	305.7

5. Investment income

	2007 £m	2006 £m
Financial assets at fair value through income statement		
Interest income	227.2	281.0
Dividend income	349.2	431.6
Cash and cash equivalents interest income	5.8	4.3
Rental income from investment properties	129.3	155.3
Foreign currency translation differences	320.7	-
Other	125.9	75.7
Total investment income	1,158.1	947.9

In the prior year, other income included £26 0m income in respect of deferred acquisition costs transferred under Part VII (note 3) and an associated £6 6m deferred tax charge.

6. Net fair value (losses) / gains recorded in the income statement

	2007 £m	2006 £m
Net loss on financial assets at fair value through income statement	(715.9)	(260.8)
Net (loss) / gain on investment properties	(257.9)	267.2
Net loss on derivative hedging instrument	(16.1)	(25.1)
Net gain on hedged loan	15.8	24.8
Net (loss) / gain on derivative financial instruments	(32.7)	4.6
Total net fair value (loss) / gain recorded in the income statement	(1,006.8)	10.7

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

7 Net insurance claims and benefits

	2007 £m	2006 £m
With DPF	594.3	608.8
Without DPF	304.4	371.5
Gross insurance contract claims and benefits paid	898.7	980.3
With DPF	-	-
Without DPF	(202.4)	(209.5)
Reinsurers' share of insurance contract claims and benefits paid	(202.4)	(209.5)
With DPF	594.3	608.8
Without DPF	102.0	162.0
Total insurance contract claims and benefits paid	696.3	770.8
With DPF	53.9	508.5
Without DPF	65.9	107.3
Gross change in insurance contract liabilities	119.8	615.8
With DPF	-	-
Without DPF	(132.3)	(76.6)
Reinsurers' share of change in insurance contract liabilities	(132.3)	(76.6)
With DPF	53.9	508.5
Without DPF	(66.4)	30.7
Total change in insurance contract liabilities	(12.5)	539.2
Total insurance claims and benefits paid and net change in insurance contract liabilities	683.8	1,310.0

8 Finance income and finance costs

	2007 £m	2006 £m
Finance income		
Interest receivable on SWAP	22.6	22.3
Interest income from group undertakings	20.5	9.8
Total finance income	43.1	32.1
Finance costs		
Interest expense on bank overdraft	6.3	5.9
Interest payable on subordinated debt	55.5	55.7
Interest payable on swap	27.1	20.1
Other interest	0.3	0.3
Total finance costs	89.2	82.0

Finance income and interest expense on bank overdraft have been disclosed separately in 2007 to provide further information on the Company's activities. Accordingly, 2006 has also been adjusted to reflect the change in approach. This has decreased interest income (note 5) by £22.3m, decreased other income (note 5) by £5.0m, decreased management fee paid to HBOS plc (note 9) by £1.0m and increased cash and cash equivalents interest income (note 5) by £0.1m.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

9 Other operating and administration expenses

	2007 £m	2006 £m
Acquisition costs	51.7	76.6
Amortisation and impairment of intangible assets	85.0	64.1
Auditors remuneration		
Fee for statutory audit	0.7	0.4
Fee for audit of reports to regulators	0.1	-
Fees for non-audit services	-	-
Expenses relating to investment properties generating rental income	7.8	14.2
Investment management expenses	97.4	44.7
Foreign currency translation differences	-	156.9
Management fee paid to HBOS plc	191.3	143.8
Total other operating and administration expenses	434.0	500.7

The profit of the company is stated after charging an amount of £2.9m (2006 £4.0m) in respect of services received by the company which have been settled by way of share-based payment arrangements. All staff providing services to the company are employed by the ultimate parent undertaking, HBOS plc, in whose shares settlement is made. The amount charged is recharged on a proportionate basis from HBOS plc. Details of the share-based payment schemes within the HBOS Group are included on an aggregated basis in the HBOS plc consolidated financial statements.

Costs recharged for staff providing services to the Company include contributions to defined benefit and defined contribution pension schemes. Details of these schemes are included in the financial statements of HBOS plc, the ultimate holding company. Contributions to defined benefit schemes amounted to £2.6m (2006 £4.5m). Contributions to defined contribution schemes amounted to £0.9m (2006 £1.4m).

In the current year fee and commission income has been disclosed separately to provide further information on the Company's activities. The prior year income (£77.5m) has also been reclassified from management fee paid to HBOS plc to fee and commission income. The income relates to management fees received for policies reinsured with Clerical Medical Managed Funds Limited, a subsidiary undertaking.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

10 Tax on profit / (loss)

(a) Current year tax credit

	2007 £m	2006 £m
Current tax	(69 2)	69 4
UK corporation tax (charge) / credit for the period	(87 2)	59 8
UK corporation tax credit in respect of earlier periods	18 0	9 6
Deferred tax	182 2	32 5
Deferred tax credit / (charge) for the period	153 2	(89 4)
Impact of change in UK tax rate	12 2	
Deferred tax credit in respect of earlier periods	16 8	121 9
Total tax credit	113 0	101 9
	2007 £m	2006 £m
Income tax credit / (charge) relating to policyholders	74.6	(59 6)
Income tax credit relating to shareholders	38 4	161 5
Total income tax credit on profit / (loss)	113.0	101 9

(b) Reconciliation of tax on profit / (loss)

	2007 £m	2006 £m
Profit / (loss) before taxation	379 3	(5 6)
Tax on profit / (loss) at domestic corporation tax rate of 30%	(113 8)	1 7
Income not subject to tax	140.1	
Differences due to UK basis of life taxation	(19 0)	29 9
Losses not previously recognised	-	22 2
Prior year movements relating to shareholder tax	19 7	107 1
Impact of change in UK tax rate	12 2	
Effect of tax rates in foreign jurisdictions	(0 8)	0 6
Total tax attributable to shareholders	38 4	161 5
Policyholder tax	74 6	(59 6)
Total income tax credit	113.0	101 9

(c) Tax charged to equity

	2007 £m	2006 £m
Deferred tax	6.2	-
Total tax charge to equity	6.2	-
	2007 £m	2006 £m
Tax charge to equity relating to shareholders	6.2	-
Total tax charged to equity	6.2	-

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

11. Intangible assets

	Software development cost £m	2007 PVIF £m	Total £m	Software development cost £m	2006 PVIF £m	Total £m
Cost						
At 1 January	-	651 4	651 4	-	651 4	651 4
Additions	0 9	-	0 9	-	-	-
At 31 December	0 9	651 4	652 3	-	651 4	651 4
Accumulated amortisation and impairment						
At 1 January	-	(273 2)	(273.2)	-	(208 8)	(208 8)
Amortisation	-	(36 8)	(36 8)	-	(28 8)	(28 8)
Impairment	-	(48 3)	(48 3)	-	(35 6)	(35 6)
Disposals	-	-	-	-	-	-
At 31 December	-	(358 3)	(358.3)	-	(273 2)	(273 2)
Net book value at 31 December	0 9	293 1	294 0	-	378 2	378 2

The impairment of PVIF has arisen from the annual reassessment of the carrying value of this asset against its recoverable amount as at 31 December 2007

12. Property and equipment

	Property £m	2007 Total £m	Property £m	2006 Total £m
Cost				
At 1 January	202 5	202 5	149 1	149 1
Additions	25 9	25 9	103 3	103 3
Disposals	(58 4)	(58 4)	(49 9)	(49 9)
Transferred to investment properties	(8 6)	(8 6)	-	-
At 31 December	161 4	161 4	202 5	202 5
Accumulated depreciation				
At 1 January	-	-	(1 0)	(1 0)
Depreciation charge for the year	-	-	1 0	1 0
Disposals	-	-	-	-
At 31 December	-	-	-	-
Net book value at 31 December	161 4	161 4	202 5	202 5

Included within property and equipment are assets that are in the course of construction, including properties that will be classified as investment properties upon completion, amounting to £161 0m (2006 £179 4m) Included in the assets in the course of construction is land amounting to £29 7m (2006 £37 3m)

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

13 Investment properties

	2007 £m	2006 £m
Balance at 1 January	2,764.2	2,568.8
Net disposals	(240.8)	(71.7)
Transferred from property and equipment	8.6	-
Fair Value adjustments	(257.9)	267.1
Balance at 31 December	2,274.1	2,764.2

Investment properties are stated at fair value. Fair value adjustments are recorded in the income statement.

During the year ended 31 December 2007, £129.3 million (2006: £155.3 million) was recognised as rental income in the income statement and £7.8 million (2006: £14.2m) in respect of repairs and maintenance was recognised as an expense in the income statement relating to investment property.

Within additions is included an amount of £70.0m (2006: £40.8m) representing capitalised expenditure.

14 Deferred costs

	2007 Deferred acquisition costs £m	2007 Deferred origination costs £m	2007 Total £m	2006 Total £m
At 1 January	68.6	246.5	315.1	231.2
Acquisition costs deferred during the year	52.4	125.2	177.6	102.6
Transfer in year	-	-	-	26.0
Amortisation	(20.7)	(58.9)	(79.6)	(44.7)
At 31 December	100.3	312.8	413.1	315.1

The transfer in the prior year is in respect of deferred acquisition costs associated with the business transferred under Part VII (note 3).

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

15 Investment in Group undertakings

Particulars of the Company's principal Group undertakings are shown below. Other holdings in Group undertakings and participating interests are not considered to be material.

Group Undertakings	Country of Incorporation or Registration	Type of business	% Held
Clerical Medical Managed Funds Limited	England and Wales	Life Insurance	* 100.0
Halifax Life Limited	England and Wales	Life Insurance	* 100.0
Clerical Medical Forestry Limited	England and Wales	Property Investments	* 100.0
CM Venture Investments Limited	Isle of Man	Investment Company	* 100.0
Lands Improvement Holdings plc	England and Wales	Investment Company	* 100.0
CM Non Sterling Property Company S A R L	Luxembourg	Property Investments	* 100.0
CMI Universe – Euro Fixed Term Bond	England and Wales	Open-Ended Investment Company	100.0
CMI Universe – US Fixed Term Bond	England and Wales	Open-Ended Investment Company	100.0
CMI Universe – Euro Top 50 Equity	England and Wales	Open-Ended Investment Company	100.0
CMI Universe – CMIG Access 80%	England and Wales	Open-Ended Investment Company	100.0
Insight Discretionary – Investment Fund of Funds II - ICVC	England and Wales	Open-Ended Investment Company	99.9
CMI Universe – Euro Bond	England and Wales	Open-Ended Investment Company	99.3
CMI Universe – Continental Euro Equity	England and Wales	Open-Ended Investment Company	98.4
CMI Universe – US Bond	England and Wales	Open-Ended Investment Company	96.2
CMI Universe – US Equity	England and Wales	Open-Ended Investment Company	95.7
CMI Universe – Euro Currency Reserve	England and Wales	Open-Ended Investment Company	95.1
CMI Universe – Japan Equity	England and Wales	Open-Ended Investment Company	94.9
Insight Professional – UK Disc	England and Wales	Open-Ended Investment Company	87.6
CMI Universe – Japan Bond	England and Wales	Open-Ended Investment Company	80.8
Insight Discretionary – UK Gov All Mat BD	England and Wales	Open-Ended Investment Company	77.7
Insight Absolute Fund of Funds	England and Wales	Open-Ended Investment Company	76.7
CMI Universe – US Currency Reserve	England and Wales	Open-Ended Investment Company	73.9
Insight Professional – UK Small Cap	England and Wales	Open-Ended Investment Company	65.7
CMI Universe – Pacific Basin	England and Wales	Open-Ended Investment Company	61.9
Insight Discretionary – UK Index Link BD	England and Wales	Open-Ended Investment Company	58.3
CMI Universe – UK Equity	England and Wales	Open-Ended Investment Company	53.0

* These subsidiary undertakings are direct subsidiaries of the Company. All subsidiary shares held are ordinary shares.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

15 Investment in Group undertakings (continued)

	Group undertakings £m	Collective Investment Schemes £m	Total £m
Valuation			
31 December 2006	899 3	5,385 6	6,284 9
31 December 2007	935 9	5,223 3	6,159 2
Cost			
31 December 2006	899 3	4,650 9	5,550 2
31 December 2007	935 9	4,626 0	5,561 9

16 Reinsurance assets

	2007 £m	2006 £m
Reinsurers' share of insurance contracts (note 22)	2,294 2	2,161 9
Reinsurers' share of investment contracts (note 24)	8,802 9	8,191 0
Total reinsurance assets	11,097 1	10,352 9

	2007 £m	2006 £m
Current reinsurance assets	1,000 2	1,343 4
Non current reinsurance assets	10,096 9	9,009 5
Total reinsurance assets	11,097 1	10,352 9

17 Prepayments and accrued income

	2007 £m	2006 £m
Total prepayments	17 3	15 3
Other prepayments	17 3	15 3
Total accrued income	19 4	-
Rent	19 4	-
Total prepayments and accrued income	36 7	15 3

The carrying amounts disclosed above reasonably approximate the fair values at year end. It is expected that all prepayments and accrued income will be realised within a year from the balance sheet date.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

18 Derivative financial instruments

The Company's collateralised derivative financial instruments are held for trading. A variety of equity futures are part of the portfolio matching the unit linked investment and insurance liabilities.

The Company has also purchased interest rate swap contracts to exchange the fixed rate on the subordinated debt for a floating rate, in line with group accounting policy. The risk of a fixed interest rate is borne by Bank of Scotland Treasury.

The fair values of such arrangements at the year end are as follows:

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Interest rate contracts				
OTC swaps	45.1	36.8	126.2	22.5
OTC options	56.4	1.1	-	-
Total derivative financial assets / (liabilities)	101.5	37.9	126.2	22.5

	2007 £m	2006 £m
Current net derivative financial instruments	63.6	103.7
Non current net derivative financial instruments	-	-
	63.6	103.7

19 Financial assets at fair value through income statement

	Fair value through income statement 2007 £m	Fair value through income statement 2006 £m
Equity investments		
Listed	5,962.9	5,766.9
Unlisted	-	-
Total	5,962.9	5,766.9
Debt investments		
Listed	5,772.6	6,616.0
Unlisted	3.0	116.9
Total	5,775.6	6,732.9
Total financial assets at fair value through income statement	11,738.5	12,499.8

In order to improve the information presented in the current year the reclassification of Collective Investment Schemes (OEICs) has been revised and split between Equity and Debt investments to reflect the underlying investments held. Accordingly, 2006 has been adjusted to reflect the change in approach, reducing the reclassification to Investments in Group undertakings by £2,217.4m. These assets are now reflected in the 2006 Equity (£1,281.7m) and Debt (£935.7) investments.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

20 Insurance and other receivables

Insurance receivables

	2007 £m	2006 £m
Due from policyholders	39.5	4.0
Due from agents, brokers and intermediaries	10.0	52.7
Total insurance receivables	49.5	56.7
	2007 £m	2006 £m
Current insurance receivables	49.5	56.7
Non current insurance receivables	-	-
	49.5	56.7

Other receivables

	2007 £m	2006 £m
Due from related parties	433.7	617.9
Outstanding interest, dividends and rent	89.2	103.9
Outstanding proceeds from sale of investments	5.8	4.3
Other receivables	29.3	17.1
Total other receivables	558.0	743.2
	2007 £m	2006 £m
Current other receivables	395.0	583.2
Non current other receivables	163.0	160.0
	558.0	743.2

The carrying amounts disclosed above reasonably approximate fair values at year end

21 Cash and cash equivalents

	2007 £m	2006 £m
Cash at bank and in hand	82.8	147.1
Short term deposits	185.0	3.3
Total cash and cash equivalents	267.8	150.4

The effective interest rate on short term bank deposits was 4.1% (2006 3.5%) and these deposits have an average maturity of 1 day

Policyholder funds include £84.8m (2006 £29.7m) cash and cash equivalents. This is not available to settle liabilities outside of the policyholder funds

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

22 Insurance contract liabilities

		2007 Gross liabilities £m	2007 Reinsurance £m	2007 Net of reinsurance £m
With DPF	(a)	5,306 3	-	5,306 3
Without DPF	(b)	2,705 8	(2,294 2)	411 6
Total insurance contract liabilities		8,012 1	(2,294 2)	5,717 9

		2007 Gross liabilities £m	2007 Reinsurance £m	2007 Net of reinsurance £m
Current insurance contract liabilities		846 7	(217 5)	629 2
Non current insurance contract liabilities		7,165 4	(2,076 7)	5,088 7
		8,012 1	(2,294 2)	5,717 9

(a) Insurance contracts with DPF

		2007 Gross liabilities £m	2007 Reinsurance £m	2007 Net of reinsurance £m
Opening balance		5,869 6	-	5,869 6
Movement		(628 4)	-	(628 4)
Changes in assumptions		65 1	-	65 1
Closing balance		5,306 3	-	5,306 3

(b) Insurance contracts without DPF

		2007 Gross liabilities £m	2007 Reinsurance £m	2007 Net of reinsurance £m
Opening balance		2,632 6	(2,161 9)	470 7
Movement		158 3	(127 9)	30 4
Changes in assumptions		(55 0)	(4 4)	(59 4)
Impact of PS06/14		(30 1)	-	(30 1)
Closing balance		2,705 8	(2,294 2)	411 6

(c) Summary of (a) and (b)

		2007 Gross liabilities £m	2007 Reinsurance £m	2007 Net of reinsurance £m
Opening balance		8,502 2	(2,161 9)	6,340 3
Movement		(470 1)	(127 9)	(598 0)
Changes in assumptions		10 1	(4 4)	5 7
Impact of PS06/14		(30 1)	-	(30 1)
Closing balance		8,012 1	(2,294 2)	5,717 9

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

22 Insurance contract liabilities (continued)

		2006 Gross liabilities £m	2006 Reinsurance £m	2006 Net of reinsurance £m
With DPF	(a)	5,869 6	-	5,869 6
Without DPF	(b)	2,632 6	(2,161 9)	470 7
Total insurance contract liabilities		8,502 2	(2,161 9)	6,340 3

		2006 Gross liabilities £m	2006 Reinsurance £m	2006 Net of reinsurance £m
Current insurance contract liabilities		2,872 2	(197 5)	2,674 7
Non current insurance contract liabilities		5,630 0	(1,964 4)	3,665 6
		8,502 2	(2,161 9)	6,340 3

(a) Insurance contracts with DPF

		2006 Gross liabilities £m	2006 Reinsurance £m	2006 Net of reinsurance £m
Opening balance		6,256 9	-	6,256 9
Movement		(407 7)	-	(407 7)
Changes in assumptions		20 4	-	20 4
Closing balance		5,869 6	-	5,869 6

(b) Insurance contracts without DPF

		2006 Gross liabilities £m	2006 Reinsurance £m	2006 Net of reinsurance £m
Opening balance		2,785 2	(2,375 3)	409 9
Movement		(81 5)	144 7	63 2
Changes in assumptions		(71 1)	68 7	(2 4)
Impact of PS06/14		-	-	-
Closing balance		2,632 6	(2,161 9)	470 7

(c) Summary of (a) and (b)

		2006 Gross liabilities £m	2006 Reinsurance £m	2006 Net of reinsurance £m
Opening balance		9,042 1	(2,375 3)	6,666 8
Movement		(489 2)	144 7	(344 5)
Changes in assumptions		(50 7)	68 7	18 0
Impact of PS06/14		-	-	-
Closing balance		8,502 2	(2,161 9)	6,340 3

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

23 Unallocated surplus

	2007 £m	2006 £m
Opening balance	1,569 4	994 4
Movement	22 7	596 6
Changes in liability assumptions	(94 7)	(21 6)
Closing balance	1,497 4	1,569 4

24 Investment contract liabilities

		2007 Gross liabilities £m	2007 Reinsurance £m	2007 Net of reinsurance £m
Investment contracts with DPF	(a)	7,203 4	-	7,203 4
Investment contracts without DPF	(b)	12,422 1	(8,802 9)	3,619 2
Total investment contract liabilities		19,625 5	(8,802 9)	10,822 6

		2007 Gross liabilities £m	2007 Reinsurance £m	2007 Net of reinsurance £m
Current investment contract liabilities		2,462 6	(782 7)	1,679 9
Non current investment contract liabilities		17,162 9	(8,020 2)	9,142 7
		19,625 5	(8,802 9)	10,822 6

(a) Investment contracts with DPF

	2007 Gross liabilities £m	2007 Reinsurance £m	2007 Net of reinsurance £m
Opening balance	8,549 7	-	8,549 7
Movement	(1,335 9)	-	(1,335 9)
Changes in assumptions	(10 4)	-	(10 4)
Closing balance	7,203 4	-	7,203 4

(b) Investment contracts without DPF

	2007 Gross liabilities £m	2007 Reinsurance £m	2007 Net of reinsurance £m
Opening balance	11,571 8	(8,191 0)	3,380 8
Movement	850 3	(611 9)	238 4
Closing balance	12,422 1	(8,802 9)	3,619 2

(c) Summary of (a) and (b)

	2007 Gross liabilities £m	2007 Reinsurance £m	2007 Net of reinsurance £m
Opening balance	20,121 5	(8,191 0)	11,930 5
Movement	(485 6)	(611 9)	(1,097 5)
Changes in assumptions	(10 4)	-	(10 4)
Closing balance	19,625 5	(8,802 9)	10,822 6

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

24 Investment contract liabilities (continued)

		2006 Gross liabilities £m	2006 Reinsurance £m	2006 Net of reinsurance £m
Investment contracts with DPF	(a)	8,549 7	-	8,549 7
Investment contracts without DPF	(b)	11,571 8	(8,191 0)	3,380 8
Total investment contract liabilities		20,121 5	(8,191 0)	11,930 5

		2006 Gross liabilities £m	2006 Reinsurance £m	2006 Net of reinsurance £m
Current investment contract liabilities		5,483 9	(3,728 9)	1,755 0
Non current investment contract liabilities		14,637 6	(4,462 1)	10,175 5
		20,121 5	(8,191 0)	11,930 5

(a) Investment contracts with DPF

		2006 Gross liabilities £m	2006 Reinsurance £m	2006 Net of reinsurance £m
Opening balance		10,570 5	-	10,570 5
Movement		(2,022 0)	-	(2,022 0)
Changes in assumptions		1 2	-	1 2
Closing balance		8,549 7	-	8,549 7

(b) Investment contracts without DPF

		2006 Gross liabilities £m	2006 Reinsurance £m	2006 Net of reinsurance £m
Opening balance		9,709 9	(6,668 2)	3,041 7
Movement		1,860 1	(1,521 6)	338 5
Changes in assumptions		1 8	(1 2)	0 6
Closing balance		11,571 8	(8,191 0)	3,380 8

(c) Summary of (a) and (b)

		2006 Gross liabilities £m	2006 Reinsurance £m	2006 Net of reinsurance £m
Opening balance		20,280 4	(6,668 2)	13,612 2
Movement		(161 9)	(1,521 6)	(1,683 5)
Changes in assumptions		3 0	(1 2)	1 8
Closing balance		20,121 5	(8,191 0)	11,930 5

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

25 Insurance and investment contract liabilities – Terms, assumptions and sensitivities

(a) Long term assurance

The Company principally writes the following contracts which contain insurance risk

- Life assurance – the policyholder is insured against death or permanent disability usually for pre-determined amounts (principally mortality and disability risk)
- Annuity products – the policy holder is entitled to payments for life and is therefore insured against living longer than expected (principally longevity and market risk)
- Traditional with-profits business – the primary purpose of these products is to provide a long term smoothed investment vehicle to the policyholder, protecting them against short term market fluctuations. The policyholder is also usually insured against death and the policy may carry an annuity option at maturity (principally market risk)
- Unitised business - the primary purpose of these products is to provide an investment vehicle but where the policyholder is also insured against death (principally market risk)

(b) Options and guarantees

The products with the most significant guarantees and options include with-profit bonds, which allow withdrawals to be taken without penalty and bonds encashed at a specific date on guaranteed terms. In addition certain pension contracts contain an option that allows the policyholder to take an annuity benefit at any time between their 60th and 75th birthday at annuity rates that were guaranteed at the outset of the contract.

For contracts where there are guarantees and options the most significant factor determining the cost of the guarantees and options (other than economic conditions in which the option or guarantee has value) is the actual take up rate of options. The most significant factor in determining take up rates is customer behaviour which is influenced by a number of factors, including the value of the contracts, general awareness of financial matters and the quality of advice they obtain. The financial impact is dependent on the value of corresponding investments, interest rates and longevity at the time of the claim.

In order to quantify the risks of these guarantees the Company makes use of stochastic modelling techniques to determine the possible and most likely ranges of outcomes. Additionally, the Company makes use of matching techniques in order to match part of the expected cash flows arising under contracts with financial instruments.

(c) Assumptions

The key assumptions used in the measurement of liabilities for insurance contracts and investment contracts with DPF are determined by the Board on advice from the Actuarial Function Holder. Material judgment is required in the choice of assumptions relating to insurance contracts and investment contracts with DPF. The assumptions that have the greatest effect on the income statement of the Company are

Mortality and longevity rates

The process used to determine the Company's mortality and longevity assumptions starts with an internal investigation of the Company's actual mortality experience over the last five years. This investigation is updated regularly. The results of this investigation are considered in the context of a number of factors including the credibility of results (which will be affected by the volume of data available), any exceptional events that have occurred during the period being considered, any known or expected trends in underlying data and relevant published market data.

The rates derived from the Company's experience are adjusted in the light of the factors mentioned above to derive a set of "best estimate" rates. No deliberate margins for prudence are introduced as part of this process. These "best estimate" assumptions will be used in the projections of "best estimate" cash flows. For insurance and investment with DPF contracts within the non profit funds, the liabilities are assessed on a prudent basis and hence the rates used need to include a margin for adverse deviation that will increase liabilities and provide some protection from the risk that actual experience is worse than the "best estimate" assumptions. The intention is that the margin added should be sufficiently prudent that there is no significant foreseeable risk that liabilities to policyholders will not be met as they fall due. Additionally trends in mortality improvement are only anticipated where they will increase the liability, such as for annuities where for males the medium cohort mortality projection is used.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

25 Insurance and investment contract liabilities – Terms, assumptions and sensitivities (continued)

Mortality and longevity rates (continued)

The following assumptions are used

Portfolio assumptions by type of business impacting net liabilities	Mortality		Valuation rate of interest	
	2007	2006	2007	2006
Non profit Policies				
Pension Annuities				
Males	97.5% PMA92 (mc) with minimum 1.5% improvements	95% PMA92mc	4.99%	4.81%
Females	80% PFA92 (75% mc) with minimum 1% improvements	80% PFA92 with 75% of mc improvements	4.99%	4.81%
Term Assurances				
Males	60.5% AM92 Ult	85% AM92 Ult with 1/3 R6A AIDS	4.06% - 5.08%	3.15% - 4.00%
Females	58.3% AF92 Ult	100% AF92 Ult with 1/3 R6A AIDS	4.06% - 5.08%	3.15% - 4.00%
With Profit Policies				
Guaranteed Annuity Options				
Males	103% PMA92 (mc) with minimum 1.5% improvements	103% PMA92mc C=2025	Market consistent stochastic deflators calibrated to gilt yield curve	Market consistent stochastic deflators calibrated to gilt yield curve
Females	90% PFA92 (75% mc) with minimum 1% improvements	90% PFA92 C=2025		
Unitised With-profit Sterling Reserves				
Life assurance	55%-77% AM92 Ult/77%-132% AF92 Ult 49.5% AM80 Ult/132% AF80 Ult	70%-100% AM92(x+2)/AF92(x+3) Ult	4.55% Unit Growth Rate	4.50% Unit Growth Rate
Pensions	55%-88% AM/F92 Ult	60%-95% AM/F92 Ult	4.55% Unit Growth Rate	4.50% Unit Growth Rate

For life assurance policies, increased mortality rates would lead to a larger number of claims and claims occurring sooner than anticipated, increasing the expenditure and reducing profits for shareholders

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

25 Insurance and investment contract liabilities – Terms, assumptions and sensitivities (continued)

For annuity contracts, lower longevity (or equivalently, increased mortality) would decrease payments thereby reducing expenditure and increasing profits for the shareholders

Investment return

Investment Return assumptions based on the long term view of expected returns for each asset class are used to calculate the future projected cash flows relating to insurance and investment contracts with DPF. As a long term view, it necessarily involves the application of judgment. The respective investment returns for each asset class are weighted based on the actual investment portfolio and long term asset allocation strategies as appropriate to produce an investment return assumption for each class of business.

In isolation an increase in the investment return assumption for investment linked policies would lead to increased annual management charges and increased profits for the shareholder. For annuity contracts the assets and liabilities are broadly matched meaning that a change in the long term investment return would have a limited impact on shareholder profits.

Valuation rate of interest

The valuation rate of interest is the rate used to discount the projected cash flows on the contracts in order to determine the value of liabilities as at the date of reporting.

For insurance and investment with DPF contracts in the non profit funds, the liabilities are calculated using a prudent valuation rate of interest determined according to specific rules set out by the Financial Services Authority. These rules specify that the valuation rate of interest should be set by reference to a prudent estimate of the future yield on the assets of the fund with an additional prudent margin being taken to allow for future investment risk. For insurance and investment contracts with DPF in the with-profit funds the liabilities are calculated using a market consistent stochastic model calibrated to the prevailing gilt yield curve at the time of the liability assessment. The volatility of future investment returns is a key assumption within the model.

Generally an increase in the valuation rate of interest would lead to a reduction in shareholder profits.

Expense and expense inflation

Operating expense assumptions reflect the projected costs of maintaining and servicing in force policies and associated overhead expenses. The current expenses are analysed having regard to the volume and type of business in-force to derive per policy expense assumptions. These per policy assumptions are assumed to increase over the course of the projections in line with assumed inflation rates. An increase in the level of expenses would reduce profits for the shareholders.

Lapse, paid up and surrender rates (persistency)

A lapse occurs when the termination of a policy results from the non-payment of premiums due under that policy. A surrender occurs when a policyholder decides voluntarily to terminate their policy. A policy becomes paid up when premiums cease but the policy still has a value.

The process used to determine policy lapse and surrender rates is similar to that used to determine mortality and longevity rates. The previous experience of the Company is analysed using statistical techniques. As the experience can vary considerably between different product types and for policies which have been in-force for different periods, the internal analysis breaks the data down into homogeneous groups for the purpose of this analysis. This analysis is updated regularly.

The most recent experience is considered along with the results of previous analyses in order to determine "extreme estimate" assumptions. For term insurance business which has negative liabilities those liabilities are determined using high "extreme estimate" lapse assumptions, whilst for term insurance business which has positive liabilities those liabilities are determined using low "extreme estimate" lapse assumptions. For investment with DPF contracts within the with-profit fund, the liabilities are required to be determined using realistic or "best estimate" assumptions.

For all other business no lapse or surrender assumptions are used in the determination of the policy liabilities.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

25 Insurance and investment contract liabilities – Terms, assumptions and sensitivities (continued)

(c) Assumptions (continued)

Lapses and surrenders vary according to both contract type and length of time a contract has been in force. No lapses and surrenders have been presented because it is impracticable to summarise information in a meaningful way.

The impact of an increase / decrease in lapse and surrender rates on contracts without guarantees and options would most likely result in a decrease / increase in profits as the contract would no longer be / continue to be in force to generate cash flows in the future. However, for certain policies with valuable guarantees and options (principally within the with-profit fund), increased / decreased lapse and surrender rates may be beneficial / detrimental to the Company as the policyholder loses / retains the ability to exercise the potentially valuable guarantee or option when / until their policy terminates.

Discretionary participating bonus rates

The determination of distributions to insurance and investment with DPF contract policyholders is made by the Board based on local regulations and in line with arrangements in individual policy contracts. For contracts with DPF in the With-profits fund distributions to policyholders are governed by the principles and practices set out in the fund's Principles and Practices for Financial Management ("PPFM"). No changes were made to the distribution policies for contracts with discretionary participation features during the year under review.

(d) Sensitivities

In general the liabilities are broadly matched by the backing assets and hence the value of shareholder equity at the valuation date is relatively insensitive to changes in financial conditions and investment markets.

- An increase in interest rates at the valuation date would result in a reduction in shareholder equity due to a fall in the value of fixed interest investments in the shareholder fund and an increase in non-unit reserves on unit-linked insurance contracts.
- A fall in equity and property market values would result in an increase in non-unit reserves on unit-linked insurance business and hence the value of shareholder equity would reduce. Realistic reserves on contracts with DPF would fall.

The value of shareholder equity at the valuation date would also be impacted by changes in future expenses and demographic experience.

- A reduction in future maintenance expenses would increase shareholder equity due to a reduction in non-unit reserves in respect of unit-linked insurance contracts.
- An increase in morbidity and mortality rates would reduce shareholder equity, as there would be an increase in reserves for protection business and an increase in non-unit reserves for insurance contracts.
- A reduction in future surrender rates would increase shareholder equity at 31 December 2007, as there is likely to be an increase in the value of DAC. Policy liabilities on contracts without DPF would be unchanged. Realistic reserves on contracts with DPF would be likely to increase (assuming that option take-up rate remains unaltered).

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

26 Tax assets and liabilities

	2007 £m	2006 £m
Tax payable		(19 2)
Tax receivable	105 7	262 7
Total current tax asset	105 7	243 5
Deferred tax asset	(20 5)	(37 5)
Deferred tax liability	409.5	602 6
Total deferred tax liability	389 0	565 1

(a) Current tax asset

	2007 £m	2006 £m
At 1 January	243 5	146 6
Amounts (credited) / charged to the income statement	(69 2)	69 4
Tax payments made during the year	(68 6)	27 5
At 31 December	105.7	243 5

(b) Deferred tax assets and liabilities

	At 1 January 2007 £m	Charged as deferred tax to income for the year £m	Change in tax rate charged to the income statement £m	Charge to equity for the year £m	At 31 December 2007 £m
Assets					
Expenses deferred for tax purposes	(17 7)	(1 8)	-	-	(19 5)
Tax losses	(19 8)	19 8	-	-	-
Accelerated capital allowances	-	(1 0)	-	-	(1 0)
Liabilities					
Unrealised gains on investments	311 3	(123 4)	-	-	187 9
Accelerated capital allowances	14 2	(14 2)	-	-	-
Deferred costs	92 3	26 6	(7 9)	-	111 0
PVIF	145 8	(24 6)	(4 9)	-	116 3
Other insurance related items	39 0	(51 5)	0 6	6 2	(5 7)
	565 1	(170 1)	(12 2)	6 2	389 0

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

26. Tax assets and liabilities (continued)

(b) Deferred tax assets and liabilities (continued)

	At 1 January 2006	Charged as deferred tax to income for the year	Other charges to income for the year	Charge to equity for the year	At 31 December 2006
	£m	£m	£m	£m	£m
Assets					
Expenses deferred for tax purposes	26.2	(8.5)	-	-	17.7
Tax losses	10.6	9.2	-	-	19.8
Accelerated capital allowances	-	-	-	-	-
Liabilities					
Unrealised gains on investments	(243.3)	(68.0)	-	-	(311.3)
Accelerated capital allowances	(12.2)	(2.0)	-	-	(14.2)
Deferred costs	(69.3)	(16.4)	-	-	(85.7)
PVIF	(173.5)	27.7	-	-	(145.8)
Other insurance related items	(129.5)	90.5	-	-	(39.0)
Attributable to Part VII transfer (note 3)	-	-	(6.6)	-	(6.6)
	(591.0)	32.5	(6.6)	-	(565.1)

	2007 £m	2006 £m
At 1 January	565.1	591.0
Charged as deferred tax to income for the year	(170.1)	(32.5)
Impact of change in UK tax rate	(12.2)	-
Other charges to income for the year	-	6.6
Charge to equity for the year	6.2	-
At 31 December	389.0	565.1

Included within 2006 other charges for the year is £6.6m in respect of a deferred tax liability associated with deferred acquisition costs transferred under Part VII (note 3)

Deferred tax assets are recognised for tax losses carried forward only to the extent that realisation of the related tax benefit is probable. Deferred tax assets have not been recognised in respect of unrelieved capital losses of £3.9m (2006 £3.9m), as there is insufficient certainty as to the availability of future profits. These amounts have no expiry date.

As a result of the Finance Act 2007, the main UK Corporation Tax Rate will reduce from 30% to 28% in April 2008. Deferred tax balances that are not expected to have been realised by April 2008 have been restated at the rate of 28%.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

27. Borrowings

	2007 £m	2006 £m
Bank overdraft	51.4	41.1
Total borrowings	51.4	41.1

The borrowings as at 31 December 2007 were subject to an average variable interest rate of 6.50% (2006 5.75%)

28. Other insurance financial liabilities

	2007 £m	2006 £m
Insurance business		
Amounts payable on direct insurance business	98.0	82.6
Investment securities and debts		
Outstanding purchases of investment securities	1.1	6.9
Total other insurance financial liabilities	99.1	89.5

The estimated fair values of amounts due are the amounts repayable within the next 12 months and are the amounts as recorded at year end

29. Accruals and deferred income

	2007 £m	2006 £m
Accruals	10.6	7.6
Deferred income	17.6	11.7
Total accruals and deferred income	28.2	19.3

	2007 £m	2006 £m
Current accruals and deferred income	10.6	7.6
Non current accruals and deferred income	17.6	11.7
Total accruals and deferred income	28.2	19.3

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

30. Trade and other liabilities

	2007 £m	2006 £m
Amounts due to related parties	131.8	183.4
Trade payables	-	0.4
Social security and other taxes	4.0	5.5
Balances due to brokers	19.5	4.5
Other	69.1	73.0
Total trade and other liabilities	224.4	266.8

The estimated fair values of trade and other liabilities are the amounts repayable on demand and are the amounts as recorded at year end

31. Subordinated liabilities

In June 2005 Clerical Medical Finance plc, a fellow subsidiary undertaking, issued €750m of 4.25% undated Subordinated Guaranteed Bonds (current sterling value £542.0m). Redemption of the bonds is at the option of HBOS Financial Services Ltd, the Company's parent undertaking, and is generally not allowable prior to 27 June 2015, after which time if the bond has not been redeemed floating rate interest is payable. The effective interest rate of the bond is 4.4%.

In July 2001 Clerical Medical Finance plc, issued €400m of 6.45% dated Subordinated Guaranteed Bonds maturing on 5 July 2023 (current sterling value £291.5m). Redemption of the bonds is at the option of HBOS Financial Services Ltd and is generally not allowable prior to July 2013, after which time if the bond has not been redeemed floating rate interest is payable. The effective interest rate of the bond is 6.6%.

Previously Clerical Medical Finance plc issued £200.0m of 7.38% undated Subordinated Guaranteed Bonds (current sterling value £197.3m), the redemption of which is at the option of HBOS Financial Services Ltd and is generally not allowable prior to 5 November 2019. The first tranche of £150.0m was issued in November 1999 and the remainder in December 2000. The bonds are guaranteed on a subordinated basis by the Company, after the claims of the Company's senior creditors including all policyholders. The proceeds of both were loaned to the Company on similar interest, repayment and subordination terms as those applicable to the Bonds. The effective interest rate of the first tranche is 7.8% and the second is 7.2%.

The fair value together with the carrying amount shown in the balance sheet is as follows

	2007		2006	
	Carrying amount £m	Fair value £m	Carrying amount £m	Fair value £m
Subordinated liabilities	1,030.8	1,003.8	965.6	1,109.5

The fair value of the subordinated guaranteed bonds is their open market value. The carrying value is calculated on an effective interest rate basis, adjusted for foreign exchange movements and amortised issue costs. The 2007 carrying value is stated gross of foreign exchange movement of £76.4m (2006 (£111.6m)).

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

32. Issued share capital and reserves

Ordinary shares	2007 £m	2006 £m
Authorised share capital		
1,709,000,000 ordinary shares of £1 each	1,709 0	1,709 0
Issued share capital		
1,629,000,000 ordinary shares of £1 each	1,629 0	1,629 0

In December 2001 the Company issued 159,000,000 ordinary shares of £1 each at a premium of 0.63 pence, giving rise to a share premium account of £1.0m. All shares issued are fully paid, there are no rights, preferences or restrictions attached to the shares.

Dividends

The following dividends were proposed and paid during the year

	2007 £m	2006 £m
12.52 pence per qualifying ordinary share (2006: nil)	204 0	-

Reconciliation of Shareholders' Equity	Issued Share Capital £m	Share Premium Account £m	Other Reserves £m	Retained Earnings £m	Total £m
Balance as at 1 January 2006	1,629 0	1 0	611 7	(368 1)	1,873 6
Net profit for the year	-	-	-	96 3	96 3
Balance as at 31 December 2006	1,629.0	1 0	611 7	(271 8)	1,969 9
Net profit for the year	-	-	-	492 3	492 3
Dividend paid to parent undertaking	-	-	-	(204 0)	(204 0)
Transfer of reserves	-	-	(611 7)	611 7	-
Foreign exchange translation	-	-	2 6	-	2 6
Balance as at 31 December 2007	1,629 0	1 0	2 6	628 2	2,260.8

In the prior year, other reserves of £611.7m related to reserves arising on the demutualisation of the Company in 1996. These have been transferred to retained earnings in the current period.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

33 Loan facility

In December 2005 the Company provided an upper tier two loan, with a nominal amount of £100m, which was issued to Clerical Medical Managed Funds Limited, a subsidiary undertaking. The loan has no repayment date and interest is charged at 0.25% above base rate. The loan is included in 'Other receivables' within 'Due from related parties'.

In December 2006 a loan facility was provided to Clerical Medical Venture Investments Limited, a subsidiary undertaking. The ultimate termination date of the facility is 31 December 2014 and interest is charged at 5% per annum. At 31 December 2007 the facility balance was £63m (2006: £60m), which includes compound interest. The borrowings are included in 'Other receivables' within 'Due from related parties'.

The company holds six loan portfolios with Clerical Medical Europe Financial Services B.V., a subsidiary undertaking. The borrowings are included in 'Other receivables' within 'Due from related parties'. A summary detail of each portfolio is listed below.

Portfolio Name	Initiation Date	Repayment Date	Interest Rate	Nominal Amount	Currency
Agents Alliance	July 2003	July 2008	Euribor + 100 basis points	5m	Euros
EMF	December 2002	December 2008	Euribor + 200 basis points	9m	Euros
VSP - 1	July 2003	July 2008	Euribor + 100 basis points	4m	Euros
VSP - 2	July 2005	July 2008	Euribor + 100 basis points	4.588m	Euros
Protrust	February 2004	February 2008	Euribor + 100 basis points	4.1m	Euros
Master Finance	January 2005	January 2008	Euribor + 100 basis points	1.3m	Euros

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

34 Risk management policies

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

31 December 2007	Attributable to the shareholder	Attributable directly to the with profits fund	Attributable to unit linked funds	Total Policyholder Funds *	Total insurance and investment business
	£m	£m	£m	£m	£m
ASSETS					
Intangible assets	294 0	-	-	-	294 0
Property and equipment	0 1	161 3	-	161 3	161 4
Investment properties	-	1,750 4	523 7	2,274 1	2,274 1
Deferred costs	413 1	-	-	-	413 1
Investment in Group undertakings and participating interests	953 3	4,092 7	1,113 2	5,205 9	6,159 2
Reinsurance assets	1,701 4	-	9,395 7	9,395 7	11,097 1
Prepayments and accrued income	1 5	29 5	5 7	35 2	36 7
Current tax receivable	97 6	4 5	3 6	8 1	105 7
Financial assets					
Financial assets at fair value through income statement					
Derivative assets	44 3	56 9	0 3	57 2	101 5
Equity investments	-	5,123 1	839 8	5,962 9	5,962 9
Debt investments	1,726 6	2,678 2	1,370 8	4,049 0	5,775 6
Insurance receivables	19 6	15 4	14 5	29 9	49 5
Other receivables	345 9	221 0	(8 9)	212 1	558 0
Cash and cash equivalents	183 0	58 2	26 6	84 8	267 8
Total Assets	5,780 4	14,191 2	13,285 0	27,476 2	33,256 6
LIABILITIES					
Insurance contract liabilities	1,840 5	5,306 3	865 3	6,171 6	8,012 1
Unallocated surplus	-	1,497 4	-	1,497 4	1,497 4
Deferred tax liability	203 3	157 0	28 7	185 7	389 0
Financial liabilities					
Derivative liabilities	36 3	1 6	-	1 6	37 9
Investment contract liabilities	61 0	7,203 4	12,361 1	19,564 5	19,625 5
Borrowings	51 4	-	-	-	51 4
Other insurance financial liabilities	95 6	2 1	1 4	3 5	99 1
Accruals and deferred income	28 2	-	-	-	28 2
Other liabilities	172 5	23 4	28 5	51 9	224 4
Subordinated liabilities	1,030 8	-	-	-	1,030 8
Total Liabilities	3,519 6	14,191.2	13,285.0	27,476 2	30,995 8

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

34 Risk management policies (continued)

31 December 2007	Attributable to the shareholder	Attributable directly to the with profits fund	Attributable to unit linked funds	Total Policyholder Funds *	Total insurance and investment business
	£m	£m	£m	£m	£m
EQUITY					
Issued share capital	1,629 0	-	-	-	1,629 0
Share premium account	1 0	-	-	-	1 0
Other reserves	2 6	-	-	-	2 6
Retained earnings	628 2	-	-	-	628 2
Total equity	2,260 8	-	-	-	2,260 8
Total liabilities and equity	5,780 4	14,191 2	13,285 0	27,476 2	33,256 6

* Policyholder funds include the unit linked and with-profit funds where investment risk is for the account of the policyholder and has no direct impact on the shareholder's balance sheet and accordingly have been excluded from the above shareholder analysis

31 December 2006	Attributable to the shareholder	Attributable directly to the with profits fund	Attributable to unit linked funds	Total Policyholder Funds *	Total insurance and investment business
	£m	£m	£m	£m	£m
ASSETS					
Intangible assets	378 2	-	-	-	378 2
Property and equipment	-	202 5	-	202 5	202 5
Investment properties	-	2,240 6	523 6	2,764 2	2,764 2
Deferred costs	315 1	-	-	-	315 1
Investment in Group undertakings and participating interests	949 5	5,147 2	188 2	5,335 4	6,284 9
Reassurance assets	1,542 2	-	8,810 7	8,810 7	10,352 9
Prepayments and accrued income	1 4	13 9	-	13 9	15 3
Current tax receivable	238 0	5 5	-	5 5	243 5
Financial assets					
Financial assets at fair value through income statement					
Derivative assets	28 6	97 6	-	97 6	126 2
Equity investments	-	4,929 0	837 9	5,766 9	5,766 9
Debt investments	1,338 8	3,400 9	1,993 2	5,394 1	6,732 9
Insurance receivables	55 1	-	1 6	1 6	56 7
Other receivables	348 5	409 0	(14 3)	394 7	743 2
Cash and cash equivalents	120 6	-	29 8	29 8	150 4
Total Assets	5,316 0	16,446 2	12,370 7	28,816 9	34,132 9

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

34 Risk management policies (continued)

31 December 2006	Attributable to the shareholder	Attributable directly to the with profits fund	Attributable to unit linked funds	Total Policyholder Funds *	Total insurance and investment business
	£m	£m	£m	£m	£m
LIABILITIES					
Insurance contract liabilities	1,716 1	5,869 6	916 5	6,786 1	8,502 2
Unallocated surplus	-	1,569 4	-	1,569 4	1,569 4
Deferred tax liability	260 1	251 7	53 3	305 0	565 1
Financial liabilities					
Derivative liabilities	20 9	1 6	-	1 6	22 5
Investment contract liabilities	157 3	8,549 7	11,414 5	19,964 2	20,121 5
Borrowings	(23 1)	64 3	(0 1)	64 2	41 1
Other insurance financial liabilities	80 8	7 6	1 1	8 7	89 5
Accruals and deferred income	19 3	-	-	-	19 3
Other liabilities	149 1	132 3	(14 6)	117 7	266 8
Subordinated liabilities	965 6	-	-	-	965 6
Total Liabilities	3,346 1	16,446 2	12,370 7	28,816 9	32,163 0
EQUITY					
Issued share capital	1,629 0	-	-	-	1,629 0
Share premium account	1 0	-	-	-	1 0
Other reserves	611 7	-	-	-	611 7
Retained earnings	(271 8)	-	-	-	(271 8)
Total equity	1,969 9	-	-	-	1,969 9
Total liabilities and equity	5,316 0	16,446 2	12,370 7	28,816 9	34,132 9

(a) Unit Linked Funds

For unit linked funds the policyholders carry the investment risk with any changes in the underlying investments being reflected by an equal change in the underlying investment contract liabilities. Accordingly, credit, liquidity, interest and market risks related to the unit linked investments, investment contract liabilities and other related balances are excluded from our assessment of risks and sensitivities impacting on the Company. However, we note that an overall change in the market value of these funds will have an indirect impact on the Company through the collection of annual management and fund related charges. If the market increases these charges increase. If the market falls these charges will fall. These charges typically range between 0.5% and 1.5% per annum.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

34 Risk management policies (continued)

(b) With-Profit Fund

The With-profit fund takes some investment risks with the aim of enhancing policyholder returns. The costs of guarantees are spread across contracts in the fund, but there remains a risk that the shareholder may have to fund guarantees on contracts.

For 'unitised' with-profit contracts the shareholder receives an annual management charge, typically ranging between 0.5% and 1.5% per annum, so that the risks to the shareholder are similar to unit linked contracts.

For 'traditional' with-profit contracts, which form the minority of the with-profit fund business, the shareholder receives one ninth of bonuses declared to policyholders as long as there is a distributable surplus within the fund.

In other respects, credit, liquidity, interest and market risks have little impact on the shareholders. The impact on profit and equity is via the shareholders' share of bonuses or in extreme scenarios where the fund is unable to meet its capital requirements. Accordingly, the related balances are not considered further in our assessment of financial risks impacting the Company.

The most important measures in controlling the risk within the with-profit fund include the pooling of with-profit risk, having agreed management actions to adjust the level of equity exposure in response to certain investment conditions, by recognising and holding appropriate levels of risk capital, by restricting holdings to assets which meet admissibility criteria, and by using derivative strategies to reduce downside risk. Through these actions, the shareholder is largely protected from an erosion of capital resources within the UK with-profit fund.

The Company has considered the financial risks of the with-profit fund along with the non profit fund and shareholders' assets and liabilities in the tables that follow. All linked and with-profit assets are considered to be current.

(c) Non Profit Business

The principal investment risk in the respect of the non profit business 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. These risks are controlled by processes carried out to ensure an appropriate level of matching is maintained in the funds so that changes in fixed interest assets are substantially mitigated by offsetting changes in liabilities as well as through the use of and monitoring against fund mandates.

34.1 Risk Management Framework

34.1 (a) Governance

The risks associated with the activities of the Company are overseen by the Risk Control Committee of the Insurance & Investment Division of HBOS plc. The Committee, which is chaired by a Director of HBOS plc, reviews all risk and compliance issues affecting the Company, as well as the other wholly owned companies within the Insurance & Investment Division.

In addition to the Risk Control Committee, there are a number of other committees responsible for different aspects of corporate governance of HBOS plc and its major subsidiaries. Further details of these committees and compliance with the Combined Code on corporate governance are included in the HBOS plc annual report and accounts.

Further, there is a Long Term Business Governance Committee, the role of which is to balance the interests of policyholders and shareholders.

34.1 (b) Capital Risk Management

The Company has developed and implemented certain minimum stress and scenario tests for identifying the risks to which the business is exposed and quantifying their impact on capital. The results of these tests are reported to the Risk and Compliance Committee.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

34. Risk management policies (continued)

34.1 Risk Management Framework (continued)

34.1 (c) Regulatory

Regulators are interested in protecting the rights of the policyholders and maintaining close attention to ensure that the Company is satisfactorily managing affairs for their benefit. At the same time, the regulators are also interested in ensuring that the Company maintains appropriate solvency. Accordingly, the UK regulator and other local regulatory bodies where the entity operates not only prescribe approval and monitoring of activities but also impose certain minimum capital requirements. These include, but are not limited to, the requirement to hold sufficient capital adequacy to minimise the risk of default and insolvency on the part of the insurance companies taking into account reasonably foreseeable adverse events.

34.2 Financial risk

34.2 (a) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company manages the level of credit risk it accepts through a comprehensive credit risk policy. This includes the use of credit ratings from independent rating agencies and where not available, by internal analysis. Additionally, the policy sets out exposure limits for each type of counterparty, product types and business sectors, which at no time during the year were exceeded.

The following table provides information regarding the credit risk exposure of the equity and debt securities within the Company at 31 December 2007 by classifying them according to credit ratings of the counterparties. Policyholder funds have been excluded from the analysis as the underlying risks are for the account of the policyholders and have no direct impact on the Company's results. The credit risk associated with all other assets is not considered significant.

31 December 2007	AAA	AA	A	Other Rated	Not rated	Policyholder	Total
	£m	£m	£m	£m	£m	£m	£m
Financial assets at fair value through income statement							
Derivatives	-	-	-	-	44.3	57.2	101.5
Equity investments	-	-	-	-	-	5,962.9	5,962.9
Debt investments	662.1	970.8	88.2	5.5	-	4,049.0	5,775.6
Total	662.1	970.8	88.2	5.5	44.3	10,069.1	11,840.0

31 December 2006	AAA	AA	A	Other Rated	Not rated	Policyholder	Total
	£m	£m	£m	£m	£m	£m	£m
Financial assets at fair value through income statement							
Derivatives	-	-	-	-	28.6	97.6	126.2
Equity investments	-	-	-	-	-	5,766.9	5,766.9
Debt investments	1,129.2	80.0	93.8	0.7	35.1	5,394.1	6,732.9
Total	1,129.2	80.0	93.8	0.7	63.7	11,258.6	12,626.0

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

34 Risk management policies (continued)

34.2 (b) Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet cash commitments associated with financial instruments. Liquidity risk may result from either the inability to sell financial assets quickly at their fair values, a counterparty failing on repayment of a contractual obligation, an insurance liability falling due for payment earlier than expected, or the inability to generate cash inflows as anticipated.

The Company has determined that liquidity risk does not represent a significant exposure to its long term assurance business. This assessment is based on the fact that the majority of investment and insurance contracts are long term in nature whilst the majority of investments are held in listed, readily realisable debt and equity instruments.

The table below sets out the contractual maturity of the Company's financial liabilities (excluding those related to policyholder funds recognised at the balance sheet date). The analysis of insurance contract liabilities is based on the expected timing of amounts recognised at the balance sheet date. Policyholder funds have been excluded from the analysis as the underlying risks are for the account of policyholders and have no direct impact on the Company's results.

	Attributable to the shareholder Up to a year	Attributable to the shareholder 1- 5 years	Attributable to the shareholder Over 5 years	Total attributable to the With Profits fund and Unit Linked fund	Total shareholder and Policyholder funds
31 December 2007	£m	£m	£m	£m	£m
Insurance contract liabilities	129.3	511.7	1,199.5	6,171.6	8,012.1
Unallocated surplus	-	-	-	1,497.4	1,497.4
Financial liabilities					
Derivative liabilities	36.3	-	-	1.6	37.9
Investment contract liabilities	57.5	3.5	-	19,564.5	19,625.5
Borrowings	51.4	-	-	-	51.4
Other insurance financial liabilities	95.6	-	-	3.5	99.1
Subordinated liabilities	-	-	1,030.8	-	1,030.8
Total	370.1	515.2	2,230.3	27,238.6	30,354.2

	Attributable to the shareholder Up to a year	Attributable to the shareholder 1- 5 years	Attributable to the shareholder Over 5 years	Total attributable to the With Profits fund and Unit Linked fund	Total shareholder and Policyholder funds
31 December 2006	£m	£m	£m	£m	£m
Insurance contract liabilities	90.8	311.1	1,345.7	6,754.6	8,502.2
Unallocated surplus	-	-	-	1,569.4	1,569.4
Financial liabilities					
Derivative liabilities	20.9	-	-	1.6	22.5
Investment contract liabilities	141.7	6.5	7.6	19,965.7	20,121.5
Borrowings	(23.1)	-	-	64.2	41.1
Other insurance financial liabilities	50.7	-	30.1	8.7	89.5
Subordinated liabilities	-	-	965.6	-	965.6
Total	281.0	317.6	2,349.0	28,364.2	31,311.8

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

Risk management policies (continued)

34.3 Market risk

Market risk is the risk of change in the fair value of financial instruments from fluctuation in foreign exchange rates (currency risk), market interest rates (interest rate risk) and market prices (price risk), whether such change in price is caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market

34.3 (a) Currency risk

The Company's principal transactions are carried out in Pound Sterling and its exposure to foreign exchange risk arises primarily with respect to the Euro

The Company's financial assets are primarily denominated in the same currencies as its insurance and investment liabilities, which mitigate the foreign currency exchange rate risk for the overseas operations. In addition currency futures are used to further mitigate risk. Thus the main foreign exchange risk arises from recognised assets and liabilities denominated in currencies other than those in which insurance and investment liabilities are expected to be settled

34.3 (b) Interest rate risk

Interest rate risk is the risk that the value / future cash flows of a financial instrument will fluctuate because of changes in interest rates. The Company's interest rate risk policy requires it to manage interest rate risk by maintaining an appropriate mix of fixed and variable rate instruments and the use of interest rate swaps. The policy also requires it to manage the maturity profile of interest bearing financial assets and interest bearing financial liabilities

As a consequence, the performance of the entity is not significantly affected by the level of its exposure to interest rate risk or changes to that exposure

The impact on profit after tax of a 25bps fall in interest rates as at the 31 December 2007 is a £6.7m loss (2006 £5.4m loss). In calculating this sensitivity it is assumed that other assumptions change only if they are directly affected by the revised economic conditions. For example, consequential effects on valuation basis are allowed for

34.3 (c) Price risk

The Company's price risk exposure relates to holding financial assets and liabilities whose values will fluctuate in different ways as a result of changes in market prices other than as a result of interest and foreign exchange fluctuations. This can be due to factors specific to individual instruments, their issuers or factors affecting all instruments traded in the market. Accordingly, the Company limits its exposure to any one counterparty as well as the relevant foreign markets (refer to credit and currency exposure disclosures for concentration risks impacting price risks)

For certain long term business classes, the Company aims to hold assets whose values will move in line with the corresponding liabilities so as to limit the overall impact of price risk

The impact on profit after tax of the market value of policyholder investments being 10% on average lower during the year is £14.5m (2006 £16.5m). This sensitivity reflects the impact of market movements on charges made to the funds and investment expenses incurred. In calculating this sensitivity, it is assumed that this change occurs in isolation, with no consequential effects assumed to other assumptions

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

34 Risk management policies (continued)

34.3 (d) Insurance risk

Insurance risk is the risk that an insured event will occur including the uncertainty of the amount and timing of any resulting claim. The principal risk the Company faces under such contracts is that the actual claims and benefit payments exceed the carrying amount of insurance liabilities. This is influenced by the frequency of claims, severity of claims and subsequent development of long term claims.

The variability of risks is improved by diversification of risk of loss to a large portfolio of insurance contracts. A more diversified portfolio is less sensitive to losses arising due to particular risks in any subset of the portfolio. The variability of risks is also improved by careful selection and implementation of underwriting strategy and guidelines as well as the use of reinsurance arrangements. The Company reinsurance policy includes credit risk exposure limits to individual reinsurance groups which are dependent on credit rating and there are defined maximum retention limits for individual lives. In this way concentration of exposure to individual lives and reinsurance groups is controlled.

34.4 Capital management

34.4 (a) Capital management

The Company's capital is managed by the Board with reference to the HBOS Group Capital Committee capital management objectives and the minimum capital requirements imposed by the regulators. In order to ensure sufficient capital is maintained by the Company at all times, the Board has approved a capital buffer policy. This policy requires that the company maintain capital in excess of the minimum regulatory requirements plus the approved minimum buffer over the planning period. To the extent that the Board assesses that the Company has capital in excess of its requirements, capital may be repatriated to its parent and ultimate parent company HBOS plc.

The Company's capital includes, to the extent that they exist, the following balances on the balance sheet: called up share capital, share premium account, other reserves, retained earnings, and subordinated liabilities and other items permitted to be recognised as regulatory capital under FSA Handbook Rules and Guidance.

There have been no material changes in the Group's approach to capital management during the year.

34.4 (b) Capital Requirements

The company is directly regulated by the Financial Services Authority (FSA), who set and monitor capital requirements.

The company complied with the FSA's capital requirements throughout 2007 and 2006.

34.4 (c) Capital Structure

The company's capital is divided into tiers as directed by the Rules in the FSA Handbook. The company holds Tier 1 capital items and qualifying Tier 2 capital. Tier 1 capital comprises shareholders' funds, after adjusting for items reflected in shareholders' funds which are treated differently for the purposes of capital adequacy. Tier 2 capital comprises qualifying subordinated loan capital.

The relative holdings of tiered capital comply with the FSA's capital gearing rules.

The table shows the consolidated balances including the regulatory solo calculation used to value subsidiaries.

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

34 Risk management policies (continued)

34.4 (c) Capital Structure (continued)

	Note	2007 £m	2006 £m
Ordinary and preference share capital		1,629 0	1,629 0
Share premium		1 0	1 0
Profit and loss reserve		628 2	(271 8)
Other reserves		2.6	611 7
Other regulatory capital	(i)	2,732 4	2,688 0
Less Regulatory deductions to Tier 1 capital	(ii)	(388 7)	(551 6)
Total Tier 1 capital		4,604 5	4,106 3
Subordinated debt		1,030 8	965 6
Other qualifying Tier 2 capital		100 0	100 0
Total Tier 2 capital		1,130 8	1,065 6
Total regulatory capital before deductions			
Regulatory deductions to total capital	(iii)	(476 5)	(431 9)
Total regulatory capital after deductions		5,258 8	4,740 0

Notes

Note (i) – Other regulatory capital includes unallocated surplus, capital of regulated related undertakings and other items permitted to be treated as Tier 1 capital, such as positive valuation differences on translation of amounts to a regulatory reporting basis

Note (ii) – Regulatory deductions to Tier 1 capital include reductions in respect of goodwill and intangible assets, deductions to Tier 1 capital of regulated related undertakings and negative valuation differences on translation of amounts to a regulatory reporting basis

Note (iii) – Regulatory deductions to total capital include reductions in respect of exposures to assets in excess of regulatory limits, deductions to total capital of regulated related undertakings and inadmissible assets

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

35 Related party transactions

The Company is controlled by HBOS plc, a public listed company incorporated in the United Kingdom, whose shares are widely held by the general public

Relationship	Transactions in the Year		Outstanding Balance at 31 December	
	2007 £m	2006 £m	2007 £m	2006 £m
Parent undertaking				
- Loans granted				
HBOS Financial Services Limited	25.2	(36.6)	-	23.5
- Loans payable				
HBOS Financial Services Limited	(1.7)	-	-	(1.7)
Halifax plc	-	-	-	-
- Other payables				
Halifax plc (recharges)	210.6	4.2	(1.6)	20.1
HBOS Financial Services Limited (recharges)	174.8	217.7	(12.4)	(22.0)
HBOS Insurance & Investment Group	0.6	-	(0.8)	-
Other Group companies				
- Loans payable				
Clerical Medical Finance plc	55.7	55.7	(1,259.0)	(1,120.7)
- Loans granted				
Clerical Medical Finance plc	(38.9)	54.7	199.3	133.1
Clerical Medical International Insurance SA	15.6	(6.0)	199.4	212.0
Clerical Medical International Group	(2.1)	-	24.1	21.0
Halifax Investment Fund Managers	-	(1.7)	-	1.7
- Other payables				
Bank of Scotland Limited (recharges)	191.7	-	10.0	14.5
Insight Investment Ltd (investment charges)	15.9	16.6	(3.7)	(3.7)
Halifax Life Limited	0.5	-	(64.6)	-
Halifax Life Limited (reinsurance)	-	162.5	-	(12.2)
Clerical Medical International Group (reinsurance)	755.9	1,090.7	(24.8)	(10.6)
St Andrews Life	1.1	(0.7)	-	(0.4)
Invista	13.7	5.3	-	-
- Other receivables				
Bank of Scotland Limited	(1.4)	(2.1)	1.4	7.6
HECM Limited (recharges)	0.8	5.9	(5.9)	8.8
Subsidiaries				
- Loans granted				
Clerical Medical Managed Funds Ltd	-	(4.8)	100.0	100.0
Clerical Medical Properties	-	-	(0.9)	(0.9)
Lands Improvements	-	10.1	-	-
Clerical Medical Forestry	(0.5)	0.8	5.9	5.4
Clerical Medical Venture Investments	(3.0)	60.0	63.0	60.0
- Other receivables				
Clerical Medical Managed Funds Ltd (reinsurance)	245.0	694.5	13.9	28.6
CMI Universe Investments	-	-	-	-
Insight Investment Ltd (investment charges)	-	32.7	-	-
Clerical Medical Venture Investments	-	(60.0)	-	-
Total	1,659.5	2,299.5	(756.7)	(535.9)

CLERICAL MEDICAL INVESTMENT GROUP LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (continued)

35 Related party transactions (continued)

All the transactions summarised were entered into on an arm's length basis and settled in cash. The amounts outstanding at the end of the year are included in other receivables / payables and subordinated liabilities as appropriate. The associated repayment terms are set out in note 31 for the loans. All other balances are repayable on demand. £Nil dividends were received from Clerical Medical Venture Investments during 2007 (2006: £60m).

Key management personnel and members of their close families have undertaken transactions with the Clerical Medical Investment Group Limited and its subsidiary undertakings, joint ventures and associates in the normal course of business, details of which are given further below.

The Group's policy in relation to lending to related parties and other product offerings is disclosed in the Group accounts of HBOS plc, the ultimate parent company undertaking of Clerical Medical Investment Group Limited.

Life assurance and investment contracts (*)

	Number of key management personnel	£000
Valuation as at 1 January 2007 or date of appointment, if later	3	283
Premiums paid/amounts invested during the year	2	104
Other movements including investment returns	3	7
Total sum insured/value of investment at 31 December 2007	3	394

(*Life assurance contracts would be those with an encashment value, investment contracts would include pensions, ISA's, PEP's – whether self-selected or not - unit trusts, investments and monies held in portfolio management services, etc)

The emoluments of Directors providing services to the Company are

	2007 £	2006 £
Total emoluments	271,467	346,853
Pension contributions and entitlements	28,034	5,330
Termination benefits	48,500	-
Share based payments	38,352	41,476
Other long-term benefits	48,929	49,127

Retirement benefits are accruing to 3 (2006: 6) directors under a defined benefit scheme.

The highest paid director's emoluments are not required to be disclosed for the year ended 31 December 2007 as they fall below the appropriate threshold.

	2006 £
Highest paid director (included above)	
Emoluments	156,715
Pension contributions and entitlements	1,890

In 2006, 5 Directors exercised share options during the year and 7 Directors received shares under long-term incentive schemes in respect of their services.

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.