

**3850542**

**CLERICAL MEDICAL FINANCE PLC**

**CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED) 2011**



Member of Lloyds Banking Group plc

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**CLERICAL MEDICAL FINANCE PLC (3850542)**  
**CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)**

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CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

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**COMPANY INFORMATION**

**Board of Directors**

J Clatworthy  
G N Stewart

**Secretary**

S Mayer

**Auditors**

PricewaterhouseCoopers LLP  
31 Great George Street  
Bristol  
BS1 5QD

**Registered Office**

33 Old Broad Street  
London  
EC2N 1HZ

**Company Number**

3850542

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**DIRECTORS' REPORT**

**Principal activities and review of the business**

The Directors present the condensed interim financial statements of Clerical Medical Finance plc (the "Company"), a company domiciled and incorporated in the United Kingdom

The Company is a wholly owned subsidiary of HBOS Financial Services Limited. The Company's ultimate parent company and ultimate controlling party is Lloyds Banking Group plc ("LBG")

The Company's principal activity is to act as a finance company for Clerical Medical Investment Group Limited ("CMIG"), a fellow subsidiary undertaking. Subordinated debt raised by the Company is loaned to CMIG on similar interest and repayment terms as those applied to the subordinated debt raised by the Company.

*Litigation in Germany in relation to CMIG branch business*

CMIG is subject to claims in the German courts relating to a number of aspects of with-profits policies issued by CMIG but sold by independent intermediaries in Germany. This ongoing matter has not resulted in any impact in these financial statements. Further details of this matter are set out in note 11.

*Restructuring of Lloyds Banking Group's insurance entities*

On 1 July 2011, the Lloyds Banking Group completed a restructuring of the legal ownership of its insurance businesses as a result of which the Company's parent undertaking, HBOS Financial Services Limited, became a subsidiary of Scottish Widows Financial Services Holdings. Further details of this transaction are set out in note 13.

**Results and dividend**

The result of the Company for the half year ended 30 June 2011 is a profit after tax of £0.2m (30 June 2010: loss of £0.1m), and this has been transferred to reserves. No interim dividend was paid during the half year (30 June 2010: £nil).

The carrying value of the subordinated assets at the half year end was £592.6m (31 December 2010: £567.4m). The increase is due mainly to foreign exchange movements during the half year on Euro-denominated loans to CMIG. Interest income receivable on the subordinated assets as a percentage of the average subordinated asset in the half year was 2.57% (30 June 2010: 2.78%).

The carrying value of the subordinated liabilities at the half year end was £596.5m (31 December 2010: £571.1m). The increase is due mainly to foreign exchange movements during the half year on Euro-denominated subordinated debt. The interest expense payable on the subordinated liabilities as a percentage of the average subordinated liabilities in the half year was 2.55% (30 June 2010: 2.67%).

*Key performance indicators*

The Directors are of the opinion that the information presented in the condensed interim financial statements provides the management information necessary for the Directors to understand the development, performance and position of the business of the Company. The Company also forms part of the Insurance Division of LBG. The development, performance and position of this Division are discussed in LBG's half year report, which does not form part of this report.

**Future outlook**

The Directors consider that the Company's principal activities will continue unchanged in the foreseeable future.

**Principal risks and uncertainties**

The management of the business and the execution of the Company's strategy are subject to a number of risks. The financial risk management objectives and policies of the Company and the exposure to market risk, credit risk, and financial soundness risk are set out in note 11.

**Directors**

The names of the current Directors are listed on page 3. Changes in Directorships during the half year are as follows:

J Clatworthy	Appointed 1 January 2011
K Luscombe	Resigned 25 May 2011
G N Stewart	Appointed 25 May 2011

Particulars of the Directors' emoluments are set out in note 12.

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**DIRECTORS' REPORT (continued)**

**Statement of Directors' responsibilities**

The Directors listed below (being all the Directors of the Company) are responsible for preparing the condensed interim financial statements in accordance with applicable law and regulations. The Directors are required to prepare the condensed interim financial statements in accordance with IAS 34 'Interim Financial Reporting' as adopted by the European Union ('EU') and to disclose in the interim management report a fair review of the information required under sections 427R of the Disclosure and Transparency Rules. These include an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed interim financial statements, a description of the principal risks and uncertainties for the remaining six months of the financial year; any related party transactions that have taken place in the first six months of the current financial year that have materially affected the financial position or performance during the period, and any changes in the related party transactions described in the last annual financial statements.

**Clerical Medical Finance Plc Board of Directors**

**Directors**

J Clatworthy	Appointed 1 January 2011
K Luscombe	Resigned 25 May 2011
G N Stewart	Appointed 25 May 2011

**CLERICAL MEDICAL FINANCE PLC (3850542)****CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)****STATEMENT OF COMPREHENSIVE INCOME FOR THE HALF YEAR ENDED 30 JUNE 2011**

	Note	30 June 2011 £ 000	30 June 2010 £ 000
<b>Revenue</b>			
Interest income on loans		15,852	15,428
Gain on foreign currency exchange		74	-
<b>Total revenue</b>		<b>15,926</b>	<b>15,428</b>
<b>Expenses</b>			
Interest payable on subordinated debt		15,290	15,112
Amortisation of finance costs on subordinated debt		338	346
Loss on foreign currency exchange		-	171
<b>Total expenses</b>		<b>15,628</b>	<b>15,629</b>
<b>Profit/(loss) before tax</b>		<b>298</b>	<b>(201)</b>
Taxation	3	(79)	56
<b>Profit/(loss) for the half year</b>		<b>219</b>	<b>(145)</b>

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

The notes set out on pages 10 to 19 are an integral part of these condensed interim financial statements.

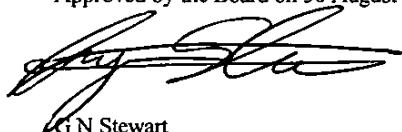
## CLERICAL MEDICAL FINANCE PLC (3850542)

## CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

## BALANCE SHEET AS AT 30 JUNE 2011

	Note	30 June 2011 £ 000	31 December 2010 £ 000
<b>ASSETS</b>			
Financial assets			
Loans receivable	4	592,630	567,362
Other receivables	5	25,406	23,546
Cash and cash equivalents	6	62	62
<b>Total assets</b>		<b>618,098</b>	<b>590,970</b>
<b>EQUITY AND LIABILITIES</b>			
Capital and reserves attributable to Company's equity shareholder			
Share capital	7	225	225
Retained earnings		4,804	4,585
<b>Total equity</b>		<b>5,029</b>	<b>4,810</b>
<b>Liabilities</b>			
Financial liabilities			
Loans payable	8	596,471	571,091
Other financial liabilities	9	16,458	15,008
Current tax payable	10	140	61
<b>Total liabilities</b>		<b>613,069</b>	<b>586,160</b>
<b>Total liabilities and equity</b>		<b>618,098</b>	<b>590,970</b>

Approved by the Board on 30 August 2011


G N Stewart  
Director

The notes set out on pages 10 to 19 are an integral part of these condensed interim financial statements

**CLERICAL MEDICAL FINANCE PLC (3850542)****CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)****STATEMENT OF CASH FLOWS FOR THE HALF YEAR ENDED 30 JUNE 2011**

	Note	30 June 2011 £ 000	30 June 2010 £ 000
<b>Cash flows from operating activities</b>			
Profit/(loss) before tax		298	(201)
Adjusted for			
Amortisation of finance costs on subordinated debt		338	346
Movement in loans receivable		(25,268)	41,912
Movement in subordinated guaranteed bonds		25,042	(42,628)
Movement in other receivables		(1,860)	770
Movement in other liabilities		1,450	(199)
<b>Net cash (outflows)/inflows from operating activities</b>		-	-
<b>Net decrease in cash and cash equivalents</b>			
Cash and cash equivalents at 1 January		62	64
<b>Net cash and cash equivalents at 30 June</b>	6	62	64

The notes on pages 10 to 19 form an integral part of these condensed interim financial statements



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**STATEMENT OF CHANGES IN EQUITY FOR THE HALF YEAR ENDED 30 JUNE 2011**

	Notes	Issued share capital £ 000	Retained earnings £ 000	Total £ 000
Balance as at 1 January 2010		225	4,429	4,654
Total comprehensive income for the half year		-	(145)	(145)
Balance as at 30 June 2010		225	4,284	4,509
Balance as at 1 January 2011		225	4,585	4,810
Total comprehensive income for the half year		-	219	219
Balance as at 30 June 2011		225	4,804	5,029

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**NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 30 JUNE 2011**

**1. Accounting policies**

**(a) Basis of preparation**

The condensed interim financial statements have been prepared in accordance with IAS 34 'Interim Financial Reporting' as adopted by the EU and the Disclosure & Transparency Rules issued by the Financial Services Authority. These are unaudited and they do not include all of the information required in preparing full annual financial statements. They should be read in conjunction with the Company's accounts for the year ended 31 December 2010, copies of which are available upon request from 33 Old Broad Street, London, EC2N 1HZ.

**(b) Section 435 Statement**

The comparative figures for the year ended 31 December 2010 included in these condensed interim financial statements do not constitute the Company's statutory accounts for that financial year within the meaning of section 435 of the Companies Act 2006 but are derived from the 2010 Annual Report & Accounts. Those accounts, which were prepared in accordance with International Financial Reporting Standards ('IFRS') and interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') as adopted by the EU, were approved by the Board of Directors on 13 April 2011 and have been delivered to the Registrar of Companies. Those accounts have been reported on by the Company's auditors, their report was unqualified, did not contain an emphasis of matter paragraph, and did not contain statements under Section 498 (2) or (3) of the Companies Act 2006.

**(c) Accounting policies**

The condensed interim financial statements have been prepared on the basis of the accounting policies as applied and disclosed in the financial statements for the year ended 31 December 2010, with the exception of the following amendments to standards which became effective on or after 1 January 2011: IAS 24 *Related Party Disclosures* and *Improvements to IFRSs* (issued May 2010). This amendment did not have a material impact on these condensed interim financial statements.

**(d) Critical accounting estimates and judgements**

The preparation of the condensed interim financial statements requires management to make judgements, estimates and assumptions that impact the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. There have been no significant changes in the basis upon which estimates have been determined, compared to that applied at 31 December 2010.

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NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 30 JUNE 2011

2 Profit before tax

No staff are employed directly by the Company (30 June 2010 none) All staff providing services to the Company are employed by other subsidiaries of LBG

No audit fees are attributable to the Company (30 June 2010 £nil)

3. Taxation

a) Current half year tax charge/(credit)

	30 June 2011 £ 000	30 June 2010 £ 000
Current Tax		
UK Corporation tax	79	(56)
<b>Total</b>	<b>79</b>	<b>(56)</b>

b) Reconciliation of tax charge/(credit)

	30 June 2011 £ 000	30 June 2010 £ 000
<b>Profit/(loss) before tax</b>	<b>298</b>	<b>(201)</b>
<b>Tax at 26.5% (2010: 28%)</b>	<b>79</b>	<b>(56)</b>
<b>Total charge/(credit)</b>	<b>79</b>	<b>(56)</b>

The Finance Act 2010 (No 2) reduced the rate of corporation tax from 28% to 27% with effect from 1 April 2011. The Chancellor's Budget, announced on 23 March 2011, further reduced the rate of corporation tax to 26% with effect from 1 April 2011. The 2011 blended rate of 26.5% has been applied in calculating the tax charge for the half year ended 30 June 2011.

The proposed further reductions in the rate of corporation tax by 1% per annum to 23% by 1 April 2014 are expected to be enacted separately each year starting in the second half of 2011. As the Company does not have any deferred tax assets or liabilities, the impact of these further reductions will be reflected in the financial statements for the year ended 31 December 2011, when the reduced rate will be applied in calculating the tax charge for that year.

4 Loans receivable

	30 June 2011 £ 000	31 December 2010 £ 000
Amounts owed by group undertakings	592,630	567,362
<b>Total</b>	<b>592,630</b>	<b>567,362</b>

The receivables relate to funds deposited with CMIG. The deposits bear nominal interest between 4.27% and 7.61% depending on the terms of the specific deposit. Further information in respect of amounts owed by group undertakings is given in note 12.

The balances above include £9,182k (31 December 2010 £8,507k) due from CMIG in respect of amortised transaction costs.

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**NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 30 JUNE 2011**

**5. Other receivables**

	30 June 2011 £ 000	31 December 2010 £ 000
Accrued interest receivable	19,442	17,582
Other amounts owed by group undertakings	5,964	5,964
<b>Total</b>	<b>25,406</b>	<b>23,546</b>

The above receivables are owed by group undertakings. Further information in respect of amounts owed by group undertakings is given in note 12.

**6. Cash and cash equivalents**

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

	30 June 2011 £ 000	31 December 2010 £ 000
Cash at bank	62	62
<b>Total</b>	<b>62</b>	<b>62</b>

**7. Share capital**

	30 June 2011 £ 000	31 December 2010 £ 000
<b>Authorised share capital:</b>		
225,000 ordinary shares of £1 each	225	225
<b>Allotted, called up and fully paid share capital:</b>		
225,000 ordinary shares of £1 each	225	225

There were no changes in ordinary share capital during the half year.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company.

**8. Loans payable**

This note provides information about the contractual terms of the Company's interest-bearing loans and borrowings. For more information about the Company's exposure to interest rate and foreign currency risk, see note 11.

	30 June 2011 £ 000	31 December 2010 £ 000
<b>Non-current liabilities</b>		
Subordinated guaranteed bonds	596,471	571,091
<b>Total</b>	<b>596,471</b>	<b>571,091</b>

Details of the terms for the subordinated guaranteed bonds are as follows:

£51m of 7.375% undated Subordinated Guaranteed Bonds, the redemption of which is at the option of the Company and is generally not allowable prior to 5 November 2019.

## NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 30 JUNE 2011

## 8. Loans payable (continued)

€219m of 6 45% dated Subordinated Guaranteed Bonds maturing on 5 July 2023. Redemption of the bonds is at the option of the Company and is generally not allowable prior to July 2013, after which time if the bond has not been redeemed floating rate interest is payable.

€388m of 4 25% undated Subordinated Guaranteed Bonds. Redemption of the bonds is at the option of the Company and is generally not allowable prior to June 2015, after which time if the bond has not been redeemed floating rate interest is payable.

The bonds are guaranteed on a subordinated basis by CMIG, a fellow subsidiary of LBG, after the claims of CMIG's senior creditors including all policyholders.

The proceeds of each bond issue were loaned to CMIG on similar interest, repayment and subordination terms as those applicable to the Bonds as detailed in note 4.

## 9. Other financial liabilities

	30 June 2011 £ 000	31 December 2010 £ 000
Accrued interest on subordinated guaranteed bonds	15,322	13,872
Amounts due to group undertakings	1,136	1,136
<b>Total</b>	<b>16,458</b>	<b>15,008</b>

## 10. Tax liabilities

	30 June 2011 £ 000	31 December 2010 £ 000
Current tax payable	140	61
<b>Total</b>	<b>140</b>	<b>61</b>

## 11. Risk management

The Company's principal activity is to act as a finance company for CMIG, a fellow subsidiary undertaking. Subordinated debt raised by the Company is loaned to CMIG on similar interest and repayment terms as those applied to the subordinated debt raised by the Company.

This note summarises these risks and the way in which the Company manages them.

## (a) Governance framework

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

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

An enterprise-wide risk management framework for the identification, assessment, measurement and management of risk is in place. The framework is in line with Lloyds Banking Group's risk management principles and covers the full spectrum of risks that the Company is exposed to. Under this framework, risks are categorised according to an approved Lloyds Banking Group risk language which has been adopted across the Company.

NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 30 JUNE 2011

**11 Risk management(continued)**

This covers the principal financial risks faced by the Company, including the exposures to market, insurance, credit and financial soundness risk. The performance of the Company, its continuing ability to write business and the strategic management of the business depend on its ability to manage these risks.

Lloyds Banking Group retains primary responsibility for the management of investment risks arising within the Company. These are managed in line with the risk policies for Lloyds Banking Group and for the Life Pensions & Investments ("LP&I") business unit, which includes the Company and CMIG. Responsibility for the management of all other risks resides with the Board of the Company who have delegated their authority to the LP&I Executive Committee.

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

**(b) Risk appetite**

The Company, through its participation in the risk management procedures in place for the LP&I business unit, has defined the methodology for the management of risk appetite. Where appropriate for each risk component, limits are defined by these procedures in terms of the amount of capital required to be held to cover certain specified stressed scenarios.

Exposure to each type of risk is monitored against prescribed limits and the results of these tests are reported to the LP&I Executive Committee. Where the exposure to any risk exceeds a trigger amount, the LP&I Executive Committee must approve an action plan to reduce the exposure or the Company's Board must approve a revised limit.

**(c) Financial risks**

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

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

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. As stated in the financial statements for the year ended 31 December 2010, the summary of significant accounting policies (note 1) describes how the classes of financial instruments are measured and how income and expenses, including fair value gains and losses, are recognised. These accounting policies remain unchanged at the half year ended 30 June 2011.

## NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 30 JUNE 2011

## 11. Risk management(continued)

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

	30 June 2011 £ 000	31 December 2010 £ 000
<b>Financial assets</b>		
Cash and cash equivalents	62	62
At fair value through income		
Accrued interest receivable	19,442	17,582
At amortised cost		
Loans receivable	592,630	567,362
Other receivables	5,964	5,964
<b>Total assets</b>	<b>618,098</b>	<b>590,970</b>
<b>Financial liabilities</b>		
At amortised cost		
Loans payable	596,471	571,091
Other financial liabilities	16,458	15,008
	<b>612,929</b>	<b>586,099</b>
<b>Other liabilities</b>		
Current tax payable	140	61
<b>Total liabilities</b>	<b>613,069</b>	<b>586,160</b>

## (1) Market risk

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

The fair values together with the carrying amounts of those assets and liabilities affected by market risk shown in the balance sheet are as follows

	30 June 2011		31 December 2010	
	Carrying amount £000	Fair value £000	Carrying amount £000	Fair value £000
Cash and cash equivalents	62	62	62	62
Loans to group undertaking	592,630	519,383	567,362	489,668
Subordinated guaranteed bonds	(596,471)	(519,383)	(571,091)	(489,668)

The carrying amount of Loans to group undertakings above includes £9,182k (31 December 2010 £8,507k) due from CMIG in respect of amortised transaction costs

The carrying amount of Subordinated guaranteed bonds above is recognised initially at fair value, being the issue proceeds net of transaction costs incurred, and subsequently stated at amortised cost using the effective interest method

The fair value of Loans to group undertakings and Subordinated guaranteed bonds above are based on the open market value of the Subordinated guaranteed bonds, excluding amortised transaction costs

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**NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 30 JUNE 2011**

**11 Risk management (continued)**

**(i) Equity and property risk**

The Company is not exposed to equity or property risk through its financial assets and financial liabilities

**(ii) Interest rate risk**

*Effective interest rates and re-pricing analysis*

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they re-price

	Note	Effective Interest rate	30 June 2011			Effective Interest rate	31 December 2010		
			Total £000	6 months or less £000	More than 5 years £000		Total £000	6 months or less £000	More than 5 years £000
Cash and cash equivalents	6	0.5%	62	62	-	2.0%	62	62	-
Loans to group undertaking	4								
GBP		7.8%	48,328	-	48,328	7.8%	48,326	-	48,326
Euro		6.6%	195,789	-	195,789	6.6%	186,810	-	186,810
Euro		4.4%	348,513	-	348,513	4.4%	332,226	-	332,226
Subordinated guaranteed bonds	8								
GBP		7.6%	(50,259)	-	(50,259)	7.6%	(50,242)	-	(50,242)
GBP		7.3%	(136)	-	(136)	7.3%	(136)	-	(136)
Euro		6.5%	(197,846)	-	(197,846)	6.5%	(188,724)	-	(188,724)
Euro		4.4%	(348,230)	-	(348,230)	4.4%	(331,989)	-	(331,989)

Interest rates on interest-bearing financial assets and financial liabilities are closely matched. Any increase or decrease in interest rates would, therefore, not have a material impact on profit and loss.

**(iii) Foreign exchange risk**

Foreign exchange risk relates to the effects of movements in exchange markets including changes in exchange rates.

The interest receivable and payable, and the value of the Company's assets and liabilities, may be affected by currency translation movements, as some of the assets and liabilities are denominated in currencies other than sterling which is the Company's functional currency. The Directors believe that the impact of such moves are not significant since the assets of the Company held in currency are substantially matched by liabilities in the same currency.

The Company receives income and pays expenses in currencies other than sterling and the sterling values of these transactions can be affected by movements in exchange rates, likewise however the value of the income and expenses are substantially matched.

The value of the net asset exposure to currencies other than sterling (all Euro) is £1,174k (31 December 2010: £804k).

**(2) Credit risk**

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

Credit risk is managed in line with the LP&I Credit Risk Policy and the wider Lloyds Banking Group Credit Risk Policy.



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**NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 30 JUNE 2011**

**11. Risk management(continued)**

The Company is primarily exposed to credit risk through the subordinated guaranteed bonds loaned on to CMIG. Accordingly the Company is dependent upon CMIG to meet its commitments in respect of the subordinated guaranteed bonds issued. Management therefore monitors closely the solvency position and the credit risk exposure of CMIG and the Company.

*Litigation in Germany in relation to CMIG branch business*

CMIG is subject to claims in the German courts relating to a number of aspects of with-profits policies issued by CMIG but sold by independent intermediaries in Germany, principally during the late 1990s and early 2000s. Where appropriate, CMIG is defending the claims and any subsequent appeals including appeals to the Federal Court of Justice. CMIG has concluded it is not currently practicable to reliably estimate the potential financial effects, which could be material to CMIG, as these can only be known after the final determination of the proceedings, the timing of which remains uncertain.

Having noted the current status of the CMIG litigation, Management are satisfied that as a consequence of the risk management procedures in place, the credit risk of the Company is being suitably managed.

There were no past due or impaired financial assets at 30 June 2011 (31 December 2010: none). No terms in respect of financial assets had been renegotiated at 30 June 2011 or 31 December 2010.

**(3) Financial soundness risk**

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

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

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

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

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

**(ii) Liquidity risk**

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

Liquidity risk is managed in line with the Lloyds Banking Group Funding and Liquidity Risk Policy.

Liquidity risk has been analysed as arising from the settlement of balances owed to other group undertakings of £1,136k (31 December 2010: £1,136k). These amounts are all contractually due within one month from the reporting date.

**(iii) Capital risk**

Capital risk is defined as the risk that

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

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**NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 30 JUNE 2011**

**11 Risk management (continued)**

The Company's objectives when managing capital are to have sufficient capital to safeguard the Company's ability to continue as a going concern

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

The Company's capital comprises all components of equity, movements in which are set out in the statement of changes in equity. The Company receives most of its funding from its parent and does not raise funding externally

**12 Related party transactions**

**(a) Ultimate parent and shareholding**

The Company's immediate parent undertaking is HBOS Financial Services Limited, a company registered in the United Kingdom. HBOS Financial Services Limited has taken advantage of the provisions of the Companies Act 2006 and has not produced consolidated financial statements

The Company's ultimate parent company and ultimate controlling party is Lloyds Banking Group plc, which is also the parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the Company is a member

At the balance sheet date, HBOS plc was the parent undertaking of the smallest such group of undertakings. Copies of the Lloyds Banking Group plc financial statements in which the Company is consolidated can be obtained from the Group Secretary's Department, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN. On 1 July 2011, the Company ceased to be a member of the HBOS plc group of undertakings. See note 13 for further details

**(b) Transactions and balances with related parties**

**Transactions between the Company and other companies in the Lloyds Banking Group**

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

Relationship	Transactions in the half year to		Outstanding Balance at	
	30 June	30 June	30 June	31 December
	2011	2010	2011	2010
	£000	£000	£000	£000
<b>Parent undertakings:</b>				
Tax charge settlement and amounts payable	-	(242)	(1,136)	(1,136)
<b>Other related parties</b>				
Interest and loans receivable	27,128	(16,040)	618,036	590,908

All the transactions summarised above were entered into on an arm's length basis. The amounts outstanding at the end of the half year are included in loans receivable, other receivables / payables as appropriate and are repayable on demand unless otherwise specified in the relevant note. The Company paid no dividends to its parent company in the half year ended 30 June 2011 (30 June 2010: £nil)

The principal activity of the Company is to act as a finance company of Clerical Medical Investment Group Limited, a fellow subsidiary undertaking. In consequence, subordinated debt raised by the Company is loaned to Clerical Medical Investment Group Limited on similar interest, repayment and subordinated terms as those applied to the bonds. For further information see note 8 above

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**NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 30 JUNE 2011**

**12. Related party transactions (continued)**

**Transactions between the Company and key management personnel**

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

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

**Key management compensation**

Certain members of key management in the Company, including the highest paid director, provide services to other companies within the Lloyds Banking Group. In such cases, for the purposes of this note, figures have been included based on an apportionment to the Company of the total compensation earned. The Directors of the Company do not spend a significant proportion of their time providing services directly to the Company and consequently no Directors' emoluments are disclosed for the half year ended 30 June 2011 (30 June 2010: £nil).

**HM Treasury**

In January 2009, HM Treasury became a related party of the Company following its subscription for ordinary shares in Lloyds Banking Group plc, the Company's ultimate parent company, issued under a placing and open offer. As at 30 June 2011, HM Treasury held a 40.2 percent (31 December 2010: 40.6 percent) interest in Lloyds Banking Group's ordinary share capital and, consequently, HM Treasury remained a related party of the Company throughout the half year ended 30 June 2011.

There were no material transactions between the Company and HM Treasury during the half year ended 30 June 2011 (30 June 2010: none) that were not made in the ordinary course of business or that are unusual in their nature or conditions. In addition, the Company has entered into transactions with HM Treasury on an arm's length basis including, but not exclusively in relation to, the payment of corporation tax, employment tax, and value added tax. Owing to the volume and diversity, such transactions are not disclosed.

**13. Events after the balance sheet date**

*Restructuring of Lloyds Banking Group's insurance entities*

On 1 July 2011, Lloyds Banking Group completed a restructuring of the legal ownership of its insurance businesses, as a result of which the Company's parent undertaking, HBOS Financial Services Limited, became a subsidiary of Scottish Widows Financial Services Holdings. As a result of this transaction, the Company ceased to be a member of the HBOS plc group of undertakings. The Company's ultimate parent company and ultimate controlling party is Lloyds Banking Group plc and therefore remains unchanged. The Directors are of the opinion that this transaction has no material impact on the Company's Financial Statements.