Scottish Widows Fund Management Limited

Directors' report and financial statements
For the year ended 31 December 2012

Registered office

15 Dalkeith Road
Edinburgh
EH16 5BU

Registered number

SC074517

Directors

A N Davis
R W Fletcher
T E Strauss

Company secretary

T C Nicholls

Member of Lloyds Banking Group

Directors' report

For the year ended 31 December 2012

The directors present their report and the audited financial statements of Scottish Widows Fund Management Limited ("the Company") for the year ended 31 December 2012.

Business review

Principal activities

The Company is a limited company incorporated and domiciled in Scotland (registered number: SC074517).

The Company's results for the year show a profit after taxation of £20,000 (2011: £32,000) and this has been transferred to reserves.

The directors consider this result to be satisfactory in light of the activities of the Company during the year and prevailing interest rates.

During the year ended 31 December 2012, the Company did not trade. The results for the year reflects the investment income earned on investments net of tax.

On 1 July 2011, the Lloyds Banking Group ("the Group") undertook a restructuring project to integrate and simplify the Insurance Division legal entity structure and improve the capital efficiency of the Group. As part of the project, the Company was sold to a fellow subsidiary. Consequently, the Company's immediate parent undertaking changed from Scottish Widows Group Limited to Scottish Widows Financial Services Holdings.

Future outlook

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

As of 1 April 2013, the Company is regulated by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA"). This is a result of the Financial Services Authority ("FSA") restructure.

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 principal risk management objectives and policies of the Company and the exposure to financial, capital and liquidity risk are set out in note 12.

Key performance indicators

The directors believe that the Company currently has adequate capital resources and will continue to do so in the foreseeable future. Further information on the capital position of the Company is given in note 12.

The directors are of the opinion that the information contained in the Company's returns on capital resources and requirements to the PRA and FCA, in conjunction with the information presented in the financial statements as a whole, provides the management information necessary for the directors to understand the development, performance and position of the business of the Company.

The development, performance and position of the Scottish Widows group are discussed in the Annual Report and Accounts of the Group, which does not form part of this report.

Policy and practice on payment of suppliers

The Company follows "The Prompt Payment Code" published by the Department for Business Innovation and Skills (BIS) regarding the making of payments to suppliers. Information about the "Prompt Payment Code" may be obtained by visiting www.promptpaymentcode.org.uk.

The Company's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated.

It is the policy of the Company to abide by the agreed terms of payment, provided the supplier performs according to the terms of the contract.

As no amounts are owed to trade creditors as at 31 December 2012, the number of days required to be shown in this report, to comply with the provisions of the Companies Act 2006, is nil (2011: nil).

Dividends

No dividends were paid or proposed during the year ended 31 December 2012 (2011: £nil).

Going concern

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

Directors' report (continued)

For the year ended 31 December 2012

Directors

The names of the current directors are shown on the cover.

The following changes have taken place during the year or since the year end:

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

Directors' indemnities

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

Statement of directors' responsibilities

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

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

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

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

Disclosure of information to auditors

Each director in office at the date of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- the director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given, and should be interpreted, in accordance with the provisions of section 418 of the Companies Act 2006.

Independent auditors

PricewaterhouseCoopers LLP are deemed to be re-appointed as auditors under section 487(2) of the Companies Act 2006.

On behalf of the board of directors

Andrew N Davis

A N Davis
Director

23 April 2013

Independent auditors' report to the member of Scottish Widows Fund Management Limited

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

Respective responsibilities of directors and auditors

As explained more fully in the Statement of directors' responsibilities set out on page 2, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Directors' report and financial statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2012 and of its profit and cash flows for the year then ended;

- have been properly prepared in accordance with IFRSs as adopted by the European Union; and

- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or

- the financial statements are not in agreement with the accounting records and returns; or

- certain disclosures of directors' remuneration specified by law are not made; or

- we have not received all the information and explanations we require for our audit.

Kevin Rollo

Kevin Rollo (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
68-73 Queen Street
Edinburgh
EH2 4NH

23 April 2013

Statement of comprehensive income

For the year ended 31 December 2012

	Note	2012 £'000	2011 £'000
Investment income		**28**	35
Finance costs		**(2)**	(2)
Profit before tax	3	**26**	33
Taxation	6	**(6)**	(1)
Profit for the year attributable to owners of the parent, being total comprehensive income		**20**	32

The notes on pages 8 to 16 are an integral part of these financial statements.

Balance sheet
As at 31 December 2012

	Note	2012 £'000	2011 £'000
ASSETS			
Cash and cash equivalents	7	**5,785**	6,107
Other current assets	8	**1**	3
Total assets		**5,786**	6,110
LIABILITIES			
Subordinated debt	9	**-**	350
Current tax liability		**15**	9
Total liabilities		**15**	359
EQUITY			
Share capital	10	**4,100**	4,100
Retained profits		**1,671**	1,651
Total equity		**5,771**	5,751
Total equity and liabilities		**5,786**	6,110

The notes on pages 8 to 16 are an integral part of these financial statements.

Approved by the board on 23 April 2013.

Andrew N Davis

A N Davis
Director

23 April 2013

Statement of changes in equity

For the year ended 31 December 2012

	Share capital £'000	Retained profits £'000	Total £'000
At 1 January 2011	4,100	1,619	5,719
Profit for the year being total comprehensive income	-	32	32
At 31 December 2011	**4,100**	**1,651**	**5,751**
Profit for the year being total comprehensive income	-	20	20
At 31 December 2012	**4,100**	**1,671**	**5,771**

Not all of the above retained earnings can be distributed to the equity holder since the Company is required to meet regulatory capital requirements. Further details are given in note 12.

The notes on pages 8 to 16 are an integral part of these financial statements.

Cash flow statement

For the year ended 31 December 2012

	Note	2012 £'000	2011 £'000
Cash flows generated from operating activities			
Profit before tax		**26**	33
Adjustments for:			
Finance costs		**2**	2
- Net decrease/(increase) in operating assets	11	**2**	(1)
Cash generated from operations		**30**	34
Taxation paid		**-**	(12)
Net cash generated from operating activities		**30**	22
Cash flows used in financing activities			
Repayments of Subordinated debt		**(350)**	-
Finance costs		**(2)**	(2)
Net cash used in financing activities		**(352)**	(2)
Net (decrease)/increase in cash and cash equivalents		**(322)**	20
Cash and cash equivalents at beginning of year		**6,107**	6,087
Cash and cash equivalents at end of year		**5,785**	6,107

The notes on pages 8 to 16 are an integral part of these financial statements.

Notes to the financial statements
For the year ended 31 December 2012

1. Accounting policies

1.1 Basis of preparation

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to both years presented, unless otherwise stated.

These financial statements have been prepared in accordance with applicable IFRSs as adopted by the European Union and the Companies Act 2006 applicable to companies reporting under IFRSs. IFRSs comprise accounting standards prefixed IFRS issued by the International Accounting Standards Board ("IASB") and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") and its predecessor body.

There are no new IFRS pronouncements relevant to the Company requiring adoption in these financial statements.

Details of those pronouncements which will be relevant to the Company but which were not effective at 31 December 2012 and which have not been applied in preparing these financial statements are given in note 16.

Historically the Balance sheet of the Company has been presented on a current/non-current basis. On review of the financial statements, the decision was made to present the Balance sheet as at 31 December 2012 and 31 December 2011 using the liquidity method, in order to make the presentation of the financial statements of the Company consistent with those of the Group.

The financial statements have been prepared on a going concern basis as detailed in the Directors' report and under the historical cost convention.

1.2 Income recognition

Investment income

Interest income for all interest bearing financial instruments is recognised within Investment income in the Statement of comprehensive income as it accrues.

1.3 Expense recognition

Finance costs

Interest expense for all interest bearing financial instruments is recognised within Finance costs in the Statement of comprehensive income as it accrues.

1.4 Financial assets and liabilities

Financial assets comprise Cash and cash equivalents and Other current assets. Financial liabilities comprise Subordinated debt which was fully repaid by 31 December 2012.

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

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

All financial assets (with the exception of Cash and cash equivalents) and financial liabilities are stated at amortised cost.

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

1.5 Cash and cash equivalents

Cash and cash equivalents includes cash at bank and investments in a liquidity fund which are accessible on demand.

1.6 Taxation, including deferred income taxes

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

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

Notes to the financial statements (continued)
For the year ended 31 December 2012

1. Accounting policies (continued)

1.7 Subordinated debt

Subordinated debt is carried at amortised cost. The subordinated loan issued is not traded and does not therefore have a market value. The redemption amount of the subordinated loan is equal to the issue proceeds.

1.8 Share capital

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

2. Critical accounting estimates and judgements in applying accounting policies

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although those estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates.

There are no significant estimates or judgements that have been used in the preparation of these financial statements.

3. Profit before tax

	2012	2011
	£'000	£'000
Investment income	**28**	35
Finance costs	**(2)**	(2)
Profit before tax	**26**	33

Investment income comprises interest earned on cash held in the Scottish Widows Investment Partnership Global Liquidity Fund.

Finance costs comprise interest payable on the Subordinated debt referred to in note 9.

Fees payable to the Company's auditors for the audit of the financial statements of £5,000 (2011: £5,500) have been borne by Scottish Widows Services Limited and are not recharged to the Company. Fees in respect of other services provided pursuant to legislation are £5,000 (2011: £5,000) have been borne by Scottish Widows Services Limited and are not recharged to the Company. Accounting and administration services are provided by a fellow subsidiary undertaking and are not recharged to the Company.

4. Staff costs

The Company did not employ any persons during the year (2011: none).

5. Directors' emoluments

No director received any fees or emoluments during the year (2011: £nil). The directors are employed by other companies within the Group and consider that their services to the Company are incidental to their other responsibilities within the Group (see also note 13).

6. Taxation

	2012	2011
	£'000	£'000
a) Analysis of charge for the year		
UK corporation tax:		
- Current tax on taxable profit for the year	**6**	1

6. Taxation (continued)

b) Factors affecting the tax charge for the year

The tax on the Company's Profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the Company as follows:

	2012 £'000	2011 £'000
Profit before tax	**26**	33
Tax charge thereon at UK corporation tax rate of 24.5% (2011: 26.5%)	**6**	8
Factors affecting charge:		
- Adjustments in respect of prior years	**-**	(7)
Tax on profit on ordinary activities	**6**	1
Effective rate	**24.5%**	3.0%

Corporation tax is calculated at a rate of 24.5% (2011: 26.5%) of the taxable profit for the year. There are no reconciling factors on the charge that would result from applying the standard UK corporation tax rate to profit before tax to the actual tax charge for the year.

On 21 March 2012, the Government announced a reduction in the rate of corporation tax to 24% with effect from 1 April 2012. This reduction was enacted under the Provisional Collection of Taxes Act 1968 on 26 March 2012. In addition, the Finance Act 2012, which passed into law on 3 July 2012, included legislation to reduce the main rate of corporation tax from 24% to 23% with effect from 1 April 2013. The change in the main rate of corporation tax from 26% to 24% has resulted in the company's profits for this accounting period being taxed at an effective rate of 24.5%.

On 5 December 2012, the Government announced a further reduction in the main rate of corporation tax to 21% from 1 April 2014. In addition, on 20 March 2013 the Government announced a further reduction in the main rate of corporation tax to 20% from 1 April 2015.

7. Cash and cash equivalents

Cash and cash equivalents for the purposes of the Cash flow statement include the following:

	2012 £'000	2011 £'000
Cash at bank	**1**	-
Investment in the Scottish Widows Investment Partnership Global Liquidity Fund	**5,784**	6,107
	5,785	6,107

8. Other current assets

	2012 £'000	2011 £'000
Accrued interest	**1**	3

9. Subordinated debt

	2012 £'000	2011 £'000
Subordinated debt	**-**	350

During 2012, the Company repaid the Subordinated debt, owed to Scottish Widows plc, in full. Scottish Widows plc is a fellow subsidiary of Scottish Widows Finance Services Holdings Limited. Interest was payable at the rate of interest earned on the investments held in the Scottish Widows Investment Partnership Global Liquidity Fund.

Notes to the financial statements (continued)
For the year ended 31 December 2012

10. Share capital

	2012	2011
	£'000	£'000
Allotted, issued and fully paid		
4,100,000 ordinary shares of £1 each	**4,100**	4,100

The immediate parent company is Scottish Widows Financial Services Holdings (incorporated in Scotland). The company regarded by the directors as the ultimate parent company is Lloyds Banking Group plc (incorporated in Scotland), 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. Lloyds TSB Bank plc is the parent undertaking of the smallest such group of undertakings. Copies of the accounts of both companies may be obtained from Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN.

11. Net decrease/(increase) in operating assets

	2012	2011
	£'000	£'000
Decrease/(increase) in operating assets:		
Other current assets (see note 8)	**2**	(1)
Net decrease/(increase) in operating assets	**2**	(1)

12. Risk management policy

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

12.1 Governance framework

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

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. The risk function provides oversight and challenge and forms 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 Group 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 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 Group risk language which has been adopted across the Group. This covers the principal risks faced by the Group, including the exposures to market, insurance, credit and financial soundness risk. The performance of the Company and the strategic management of the business depend on its ability to manage these risks.

Responsibility for the management of risk resides with the board of the Company, which has delegated its authority to the Insurance Executive Committee.

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

12.2 Risk appetite

The Company has defined the methodology for the management of risk appetite and has approved appropriate limits. Where appropriate for each risk component, limits are defined in terms of the amount of capital required to be held to cover certain specific stressed scenarios.

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

12. Risk management policy (continued)

12.3 Financial risks

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

The Company manages this risk in a number of ways, including the monitoring of cashflow requirements.

Financial assets and financial liabilities are measured on an ongoing basis at amortised cost. Descriptions of how the various classes of financial instruments are measured, as well as how income and expenses are recognised, can be found under note 1.

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

Credit risk

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

Credit risk is managed in line with the Insurance Credit Risk Policy and the Group's wider Credit Risk Policy.

The Company holds cash on deposit with Lloyds TSB Bank plc, which is A rated by Standard and Poor's and has also placed cash in the Scottish Widows Investment Partnership Limited Global Liquidity Fund, which is AAA rated. Credit risk in respect of these balances, and the associated accrued interest, is not considered to be significant.

There were no past due or impaired financial assets at 31 December 2012 (2011: none). No terms in respect of financial assets had been renegotiated at 31 December 2012 or 31 December 2011.

Market risk

Market risk is the risk of reductions in earnings and/or value, through financial or reputational loss, from unfavourable market movements. This risk typically arises from fluctuations in market prices, market interest rates and foreign exchange rates, 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 market risk that the Company is primarily exposed to is interest rate risk.

Interest rate risk

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

If interest rates were to increase or decrease by 25 basis points, the impact on profit and loss after tax would be an increase or decrease respectively of £11,000 (2011: increase or decrease respectively of £11,000) in respect of interest bearing financial assets and financial liabilities.

12.4 Financial soundness risk

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

Financial and regulatory reporting, tax and disclosure risk

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 Group 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 Group 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 Group 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.

12. Risk management policy (continued)

12.4 Financial soundness risk (continued)

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 the inability to generate cash inflows as anticipated.

Liquidity risk is managed in line with the Insurance Liquidity Risk Policy and the Group's Funding and Liquidity Risk policy.

All of the financial assets of the Company are held for managing liquidity risk. Investments in a liquidity fund of £5,784,000 (2011: £6,107,000) and cash held in a bank account of £1,000 (2011: £nil) have no stated maturity but can be accessed on demand. Other current assets of £1,000 (2011: £3,000) are generally recoverable within one month from the reporting date.

Capital risk

Capital risk is defined as the risk that:

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

The business of the Company is regulated by the PRA and FCA which specify the minimum amount of capital that must be held by the Company in addition to its liabilities.

Within the Insurance division, capital risk is actively monitored by the Insurance Finance and Capital Committee.

The minimum required capital must be maintained at all times throughout the year. These capital requirements and the capital available to meet them are regularly estimated in order to ensure that capital maintenance requirements are being met.

The Company's objectives when managing capital are:

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

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

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

The table below sets out the regulatory capital and the required capital held at 31 December in each year.

	2012 **£'000**	2011 £'000
Regulatory capital held	**5,751**	5,719
Regulatory capital requirement	**101**	109

All minimum regulatory capital requirements were met during the year.

12.5 Operational risks

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

12. Risk management policy (continued)

12.5 Operational risks (continued)

Conduct risk

Conduct risk covers the risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate or poor customer outcome. Associated risks include poor product design and development, customer advice, customer service and customer complaint handling.

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

People risk

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

Financial crime and security risk

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

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

Organisational infrastructure and change risk

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

Supplier management risk

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

IT systems risk

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

12.6 Legal and regulatory risks

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

The volume of actual and expected regulatory changes remains high where work is ongoing to review, assess and embed new regulatory requirements into day to day operational and business practices across the Group.

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

Notes to the financial statements (continued)

For the year ended 31 December 2012

13. Related party transactions

The Company is controlled by Scottish Widows Financial Services Holdings. A number of transactions are entered into with related parties in the normal course of business. These include loan and fee transactions. A summary of the outstanding balances at the year end and the related income and expense for the year are set out below.

	2012 £'000	2011 £'000
Other current assets		
Scottish Widows Investment Partnership Global Liquidity Fund (see note 8)	1	3
Cash and cash equivalents held with group undertakings		
Lloyds TSB Bank plc	1	-
Scottish Widows Investment Partnership Global Liquidity Fund	5,784	6,107
Total Cash and cash equivalents (see note 7)	5,785	6,107
Subordinated debt		
Scottish Widows plc (see note 9)	-	350
Investment income		
Scottish Widows Investment Partnership Global Liquidity Fund (see note 3)	28	35
Finance costs		
Scottish Widows plc (see note 3)	2	2

The above outstanding balances are unsecured in nature and are expected to be settled in cash or by cash equivalents. Transactions in the year are those reflected through the Statement of comprehensive income.

Key management personnel

Key management personnel are those persons having authority and responsibility for planning and controlling the activities of the Company. Accordingly, key management comprise the directors of the Company and the members of the Group. There were no transactions between the Company and key management personnel during the current or preceding year. Key management personnel are employed by other companies within the Group and consider that their services to the Company are incidental to their other activities within the Group.

HM Treasury

In January 2009, HM Treasury became a related party of the Company following its subscription for ordinary shares in the Group, the Company's ultimate parent company, issued under a placing and open offer. As at 31 December 2012, HM Treasury held a 39.2 per cent (2011: 40.2 per cent) interest in the Group's ordinary share capital and, consequently, HM Treasury remained a related party of the Company throughout 2012.

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

Notes to the financial statements (continued)
For the year ended 31 December 2012

14. Contingent liabilities and capital commitments

There were no contingent liabilities or contracted capital commitments at the balance sheet date (2011: £nil).

15. Post balance sheet events

There are no post balance sheet events requiring disclosure in these financial statements.

16. Future developments

The following pronouncements will be relevant to the Company but were not effective at 31 December 2012 and have not been applied in preparing these financial statements.

Pronouncement	Nature of change	Effective date
Improvements to IFRSs (issued May 2012) [1]	Sets out minor amendments to IFRS standards as part of annual improvements process. Most amendments clarified existing practice.	Annual periods beginning on or after 1 January 2013.
IFRS 13 Fair value Measurement	Sets out a single IFRS framework for the measurement of fair value and the related disclosure requirements.	Annual periods beginning on or after 1 January 2013.
IFRS 9 Financial Instruments: Classification and Measurement [1 & 2]	Replaces those parts of IAS 39 Financial Instruments: Recognition and Measurement relating to the classification, measurement and derecognition of financial assets and liabilities. Requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instrument. The available-for-sale financial asset and held-to-maturity categories in the existing IAS 39 will be eliminated. The requirements for financial liabilities and derecognition are broadly unchanged from IAS 39.	Annual periods beginning on or after 1 January 2015.

1. At the date of this report, these pronouncements are awaiting EU endorsement.

2. IFRS 9 is the initial stage of the project to replace IAS 39. Future stages are expected to result in amendments to IFRS 9 to deal with changes to the impairment of financial assets measured at amortised cost and hedge accounting. Until all stages of the replacement project are complete, it is not possible to determine the overall impact on the financial statements of the replacement of IAS 39.

The full impact of these pronouncements is being assessed by the Company. However, the initial view is that none of these pronouncements are expected to cause any material adjustments to the reported numbers in the financial statements.