



Financial strength

Below are answers to some questions which may be asked by professional advisers on Scottish Widows' and Clerical Medical's position following the creation of Lloyds Banking Group.

How strong are both Scottish Widows and Clerical Medical?

Both companies are well-capitalised and are amongst the strongest companies in the life and pensions industry. The Free Capital Ratio for each company is available from the annual financial reports submitted to the FSA and is a commonly used measure of a life company's financial strength. The ratio shows excess or 'free' capital resources as a proportion of liabilities – the Scottish Widows plc Free Capital Ratio* at the end of December 2008 was 14.7% and the Clerical Medical Investment Group Ltd Free Capital Ratio was 16.1%. This represents around £2.3 billion of regulatory capital in excess of what's required to meet the FSA's regulatory solvency requirements for Scottish Widows, and £2 billion in excess of requirements for Clerical Medical.

* Scottish Widows and Clerical Medical Free Capital Ratio percentage figures above show end 2008 excess (or free') capital resources as a proportion of liabilities, which for this purpose exclude unit-linked liabilities. We believe this exclusion provides a better indication of a company's capital strength given that unit-linked assets and liabilities are closely matched.

What is the capital structure of Lloyds Banking Group and how does being part of Lloyds Banking Group affect Scottish Widows' and Clerical Medical's financial strength?

The ultimate holding company for the group is Lloyds Banking Group plc (previously called Lloyds TSB Group plc). Lloyds TSB Bank plc and HBOS plc are subsidiaries of Lloyds Banking Group plc and both Scottish Widows and Clerical Medical are separate companies within the Insurance division of Lloyds Banking Group.

For both Scottish Widows and Clerical Medical, one of their key corporate assets is their financial strength. For both companies, their capital position is managed carefully to ensure that it is self-sustaining; Scottish Widows and Clerical Medical are both financially strong.

Both companies are classified as long term insurers and maintain a 'long term fund' in which the majority of their assets are held.

We believe this financial strength is reinforced by the creation of the new Insurance division within Lloyds Banking Group. This presents a remarkable opportunity to build the leading insurance business in the UK delivering peace of mind to our customers and helping them plan for their financial futures.

How do I know which company's financial strength is important when I'm selling a product?

In 2010, Scottish Widows and Clerical Medical will move toward operating as a single life, pensions and investment brand. In the meantime, both companies will remain separate, operating within the Insurance division of Lloyds Banking Group.

By streamlining our product range we've brought together the best of both organisations. We will offer one unified range of ISAs, OEICs, onshore and offshore bonds and pension products. Pension products will be provided from the Scottish Widows products suite, and investment bonds, offshore bonds, OEICs and ISAs from the Clerical Medical product suite. The exception to this is the Capital Protected Fund, which will continue to be offered as a structured investment product by Scottish Widows.

When recommending and selling onshore bonds from the Clerical Medical range, the financial strength of Clerical Medical Investment Group should be taken into consideration, and when recommending and selling pension products, the financial strength of Scottish Widows plc should be taken into consideration.

When a customer invests into an OEIC or an ISA from the Clerical Medical range, investments are made into a selection of sub funds within HBOS Investment Fund Managers Limited (HIFML). There is a capital requirement for HIFML to hold 25% of the previous year's administration expenses. HIFML is not an insurance company – it is governed by the regulations and capital requirements applicable to OEIC providers.

The Capital Protected Funds are sub-funds within Scottish Widows Investment Solutions Funds ICVC, which are subsidiaries of Scottish Widows Unit Trust Managers Ltd, a company governed by the regulations and capital requirements applicable to OEIC and unit trust providers.

How important are Scottish Widows and Clerical Medical to Lloyds Banking Group?

The following statement, dated November 2008 is taken from the Lloyds TSB Group 'PROPOSED ACQUISITION OF HBOS, PLACING AND OPEN OFFER AND NEW PREFERENCE SHARE ISSUE'

“ *The Lloyds TSB Directors believe that the Enlarged Group will have compelling propositions in General Insurance, Asset Management and Life, Pensions and Investment and that its customers will benefit from the deployment of best of breed products and efficient processes. Both Lloyds TSB and HBOS have well developed customer offerings in all three areas which will be combined to capture scale benefits whilst also providing enhanced product development and customer choice. There are also many complementary offerings expected to result from the Acquisition which are expected to provide bancassurance, IFA and institutional clients with a more wide ranging and improved service. The enlarged franchise is expected to build on its strong position and continue to provide good earnings growth. ”*

For the full report visit:

http://www.lloydsbankinggroup.com/media/pdfs/investors/2008/2008Nov3_LTSB_HBOS_Acquisition_&_Publishing_Circular.pdf

How does Clerical Medical International's financial strength stack up?

Clerical Medical's offshore products are issued by CMI Insurance Company Limited (CMI), a limited company based in the Isle of Man. CMI is Clerical Medical's specialist offshore life company which is a part of Lloyds Banking Group. CMI has had a prudent approach to management and is financially strong. At December 2008 CMI received a 'B' (Strong) rating from AKG.

CMI is in essence a unit-linked investment company where policyholders' assets and liabilities are matched within the long term business funds.

Can Lloyds Banking Group access the capital held in Scottish Widows' or Clerical Medical's long term funds?

Each company within the Lloyds Banking Group is set up as a separate legal entity with its own rights and responsibilities. The assets of each company within the Lloyds Banking Group may only be accessed by other companies within the Group in limited circumstances in accordance with company law, and only then with the consent of the company in question (which would not be given if such action was not in the best interests of that company).

The capital underpinning both Scottish Widows' and Clerical Medical's long term insurance business is subject to regulation by the FSA. Both companies can meet all the capital requirements required by this regulation and moreover have a policy of holding capital in addition to these requirements. The aim of this capital policy is, first and foremost, to enable each company to meet its obligations to its customers and both Scottish Widows and Clerical Medical will continue to manage its financial strength to do so.

Does the takeover of HBOS weaken Scottish Widows or Clerical Medical's ability to meet their obligations to customers?

No. As a result of the prudent approach taken to managing Scottish Widows long term fund, we remain financially strong as measured by the Free Capital Ratio. Clerical Medical Investment Group Ltd has also had a prudent approach to managing its long term fund and is very financially strong.

How strong is Lloyds Banking Group and how has the takeover of HBOS affected that?

Lloyds Banking Group takes a prudent approach to risk management and the relative strength and resilience of the Group's business model is supported by its robust capital position and a strong and diverse funding capability. The Group announced on 7th March its intention to participate in the Government's Asset Protection Scheme. The Asset Protection Scheme was designed to protect financial institutions against exposure to exceptional future credit losses on certain portfolios of assets.

On the 9th June Lloyds Banking Group announced the successful completion of its Placing and Compensatory Open Offer, with the proceeds being used to fully redeem the £4 billion of Preference Shares held by HM Treasury on 11th June.

As a result of the completion of the HMT Preference Share Redemption, the previous restrictions which had prevented Lloyds Banking Group from paying dividends on its Ordinary Shares have now been removed. Whilst it is not Lloyds Banking Group's intention to pay a dividend on Ordinary Shares in 2009, the intention is to resume dividend payments on its Ordinary Shares as soon as market conditions and the financial position of Lloyds Banking Group permits.

Redemption of the HMT Preference Shares also removes the £480 million annual cost of the dividends payable on the HMT Preference Shares which will thereby improve Lloyds Banking Group's profitability, cashflow, liquidity and organic capital regeneration.

The acquisition of HBOS plc created the opportunity to become the leading UK financial services group and this situation remains. The combination will drive significant synergy benefits – the Lloyds Banking Group's Board believes it will deliver total pre-tax annual cost savings greater than £1.5 billion by the end of 2011. More detail on Lloyds Banking Group 2008 results, and the Compensatory Open Offer can be found at <http://www.lloydsbankinggroup.com/investors.asp>

Is it better in the current environment to be part of a larger or standalone insurance group as opposed to being a bank owned insurer?

Regardless of their ownership structure, the business models of banks and insurers are very different and as a result the issues in terms of capital management and solvency for insurers and banks are different. An important piece of background is the introduction of 'realistic' reporting for life insurance companies in 2005. Coming off the back of the near-collapse of Equitable Life, the FSA from 2005 required large with-profits offices to publish 'realistic balance sheets' for the first time. This really tightened up the financial reporting of with-profits life companies.

Realistic reporting reflects the assets and liabilities of life offices in a more realistic way than in the past with detailed modelling of many future economic scenarios including difficult times such as those experienced in recent years. The key point is that Scottish Widows and Clerical Medical have been using realistic balance sheets since 2005, are both financially strong and, as part of Lloyds Banking Group, are well-positioned to build on recent success and maintain financial strength.

Will Scottish Widows and Clerical Medical integrate further and how might financial strength change in future as a result of this?

For the time being, Scottish Widows and Clerical Medical remain separate companies operating within the Insurance division of Lloyds Banking Group. However, they will move toward operating under the Scottish Widows brand for life, pensions and investment business, combining the best parts of both companies. Combining the product suite is the first stage in this process. Any further changes will be communicated at the earliest opportunity.

Where can I get more information?

We have created a set of material on our Financial Adviser extranet.

http://www.scottishwidows.co.uk/extranet/working_with_scottish_widows/financial_strength.html

For more information on the financial strength of Scottish Widows and Clerical Medical, please contact your usual contact.



As part of the Lloyds Banking Group, Scottish Widows is proud to be an Official Provider of the London 2012 Olympic and Paralympic Games.

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