

**ISSUED**  
August 2009

COMPANY PROFILE	&	FINANCIAL STRENGTH
R E P O R T S		

Clerical Medical

**AKG**

**Accessible - Comparative - Independent**

Analysis by AKG Actuaries & Consultants Ltd

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AKG's Company Profile & Financial Strength Reports are designed to meet the information needs of advisers and analysts in assessing the relative strengths of UK long term insurers. Two different styles of report are published by AKG - FULL reports and SHORT reports. A FULL report is produced for each of the leading provider companies in the market, which participate in the production of the reports. For each remaining provider company which is covered, a SHORT report is produced.

This is a FULL report.

Each report collates relevant information from a range of sources such as a company's returns to the FSA, its report & accounts and material provided by the companies themselves, and incorporates expert independent assessment. For FULL report companies, the process is augmented by regular meetings and other communications with AKG.

**PLEASE NOTE: This report should be read in conjunction with AKG's User Guide to AKG's Company Profile & Financial Strength Reports, a copy of which is available on-line at [www.akg.co.uk](http://www.akg.co.uk)**

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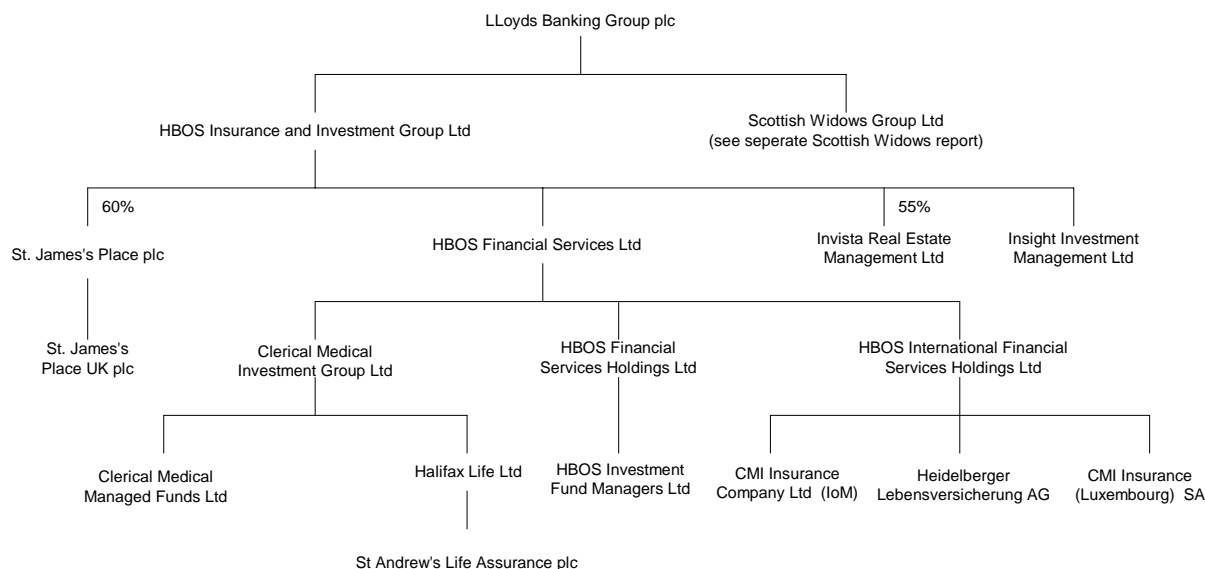
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## Overview

Lloyds TSB Group plc was renamed Lloyds Banking Group plc (LBG) in January 2009 following the acquisition of HBOS plc, to form the largest retail bank in the UK, part owned 43% by HM Treasury. Within this the Insurance Division encompasses all the insurance companies that previous operated within the two banks. Scottish Widows, acquired by Lloyds TSB plc in March 2000, distributed through the Lloyds branch network, IFAs and directly via the telephone and the internet. There are four UK life subsidiaries which operated under the Scottish Widows brand - the main company Scottish Widows plc, together with the specialist subsidiaries Scottish Widows Unit Funds Ltd (SWUFL - linked life and pensions business), Scottish Widows Annuities Ltd (SWAL - non-profit pension annuities), and Pensions Management (SWF) Ltd (PMSWFL - managed pension fund business). HBOS operated on a multi-brand, multi-channel approach, with Clerical Medical Investment Group (CMIG), Halifax Life, St. James's Place and St Andrew's Life. CMIG was the primary intermediary product provider, together with Clerical Medical Managed Funds Ltd (CMMF), CMI Insurance Co (an Isle of Man based company) and HBOS Investment Fund Managers Ltd (OEICs). CMIG is also the main product provider to the Clerical Medical Europe (CME) business, which writes business, including with profits, in several mainland European countries.

The integration of two significant financial services organisations represents both a risk and an opportunity, and it is likely to be some time before the final shape of the combined organisation is determined. At the time of writing this report it has been decided that with effect from July 2009 the LBG Insurance Division distributes its intermediary business through a combined salesforce operating under the Scottish Widows brand for pensions business. The Clerical Medical brand will be retained for some investment business but the intention is to phase out the Clerical Medical brand. In August 2009 LBG announced that it had agreed to sell Insight to BNY Mellon for £235m, following which the management of Clerical Medical funds, currently managed by Insight, will switch to Scottish Widows Investment Partnership (SWIP). Further integration in terms of the bank distribution and rationalisation of component life companies to drive capital efficiencies is also anticipated in the medium term.

## Corporate Structure (simplified)



## Ratings

Company	Financial Strength Ratings				Supporting Ratings		
	Overall	With Profits	Non Profit	Unit Linked	Service	Image & Strategy	Annual Review
Clerical Medical Investment Group Ltd	B+	★★★	★★★★★	★★★★	★★★	★★★	★★★
Clerical Medical Managed Funds Ltd	B+	■	★★★★	★★★★	★★★	★★★	★★★

See page 7 for summary of which products are written in which company.

## Summary Financial Data

### Key Financial Data (for y/e: 31/12/08)

LT Admissible Assets (by)	2006 £000's	2007 £000's	2008 £000's
Clerical Medical Investment Group Ltd	21,704,445	19,420,770	17,052,151
Clerical Medical Managed Funds Ltd	15,653,804	15,945,186	14,550,454
<b>Total Assets</b>	<b>37,358,249</b>	<b>35,365,956</b>	<b>31,602,605</b>

LT Admissible Assets (by asset type)	2006 £000's	2007 £000's	2008 £000's
Fixed Interest	5,624,488	4,595,100	4,531,249
Equities	10,089,624	8,932,529	6,709,033
Property	2,235,307	1,912,888	1,251,933
Linked	16,912,773	17,575,328	15,862,693
Other	2,496,057	2,350,111	3,247,697
<b>Total Assets</b>	<b>37,358,249</b>	<b>35,365,956</b>	<b>31,602,605</b>

LT Liabs & Margins (by type)	2006 £000's	2007 £000's	2008 £000's
Non Linked Non Profit	2,533,500	2,354,865	2,191,238
Non Linked With Profits	2,375,965	2,136,198	2,069,720
Accum'lg With Profits	11,156,929	9,302,242	8,809,824
Linked	17,127,240	17,578,151	15,810,631
Surplus c/f	739,550	625,230	509,813
Other liabilities	783,915	722,809	1,045,417
Investment Reserves	2,641,148	2,646,459	1,165,963
<b>Total Liabilities/Margins</b>	<b>37,358,248</b>	<b>35,365,954</b>	<b>31,602,606</b>

### Net Inflow Data (for y/e: 31/12/08)

Net Inflow (by Company)	2006 £000's	2007 £000's	2008 £000's
Clerical Medical Investment Group Ltd	-2,891,717	-2,336,101	-1,521,635
Clerical Medical Managed Funds Ltd	3,771,223	-286,626	46,331
<b>Net Inflow(-Outflow)</b>	<b>879,506</b>	<b>-2,622,727</b>	<b>-1,475,304</b>

Net Inflow (by payment type)	2006 £000's	2007 £000's	2008 £000's
Premiums	6,715,108	3,348,668	2,861,522
Death/disability pmts	147,810	174,714	175,034
Surrenders	5,060,346	5,184,863	3,543,825
Annuity Payments	186,445	188,157	197,705
Maturities	441,000	423,661	420,262
<b>Net Inflow(-Outflow)</b>	<b>879,506</b>	<b>-2,622,727</b>	<b>-1,475,304</b>

Net Inflow (by business type)	2006 £000's	2007 £000's	2008 £000's
UK Life	-1,238,435	-1,781,938	-1,153,208
UK Pension	3,009,096	-814,671	-392,701
Overseas	-891,155	-26,118	70,605
<b>Net Inflow(-Outflow)</b>	<b>879,506</b>	<b>-2,622,727</b>	<b>-1,475,304</b>

### New Business Data (for y/e: 31/12/08)

New Single Premiums (by Company)	2006 £000's	2007 £000's	2008 £000's
Clerical Medical Investment Group Ltd	2,108,871	2,044,764	1,665,016
Clerical Medical Managed Funds Ltd	152,560	163,280	83,238
<b>Total (Direct + External Reins)</b>	<b>2,261,431</b>	<b>2,208,044</b>	<b>1,748,254</b>

New Single Premiums (by business type)	2006 £000's	2007 £000's	2008 £000's
UK Life	443,715	459,906	283,506
UK Pensions	1,623,588	1,587,360	1,376,957
Overseas	194,128	160,778	87,791
<b>Total (Direct + External Reins)</b>	<b>2,261,431</b>	<b>2,208,044</b>	<b>1,748,254</b>

New Regular Premiums (by Company)	2006 £000's	2007 £000's	2008 £000's
Clerical Medical Investment Group Ltd	240,969	220,107	206,270
Clerical Medical Managed Funds Ltd	0	0	0
<b>Total (Direct + External Reins)</b>	<b>240,969</b>	<b>220,107</b>	<b>206,270</b>

New Regular Premiums (by business type)	2006 £000's	2007 £000's	2008 £000's
UK Life	104	65	51
UK Pensions	212,723	178,514	167,550
Overseas	28,141	41,528	38,669
<b>Total (Direct + External Reins)</b>	<b>240,969</b>	<b>220,107</b>	<b>206,270</b>

Whilst both CMIG and CMMF were impacted by the market falls in 2008, they continue to converge in overall size due to the run off of business in CMIG and the reinsurance arrangements between them. At a group level, there was again a net outflow, although reduced from 2007 after a marked fall in the level of surrender payments. Whilst new business continues to be dominated by pensions, given the decision to market Scottish Widows pensions within the enlarged LBG, future new business flows into CMIG are likely to fall substantially.

## Corporate Data

<b>Ownership</b>	Lloyds Banking Group plc
<b>Open to New Business?</b>	Yes
<b>Year Established</b>	1996
<b>Head Office</b>	10 Canons Way Bristol BS1 5LF
<b>Tel:</b>	0117 376 6000
<b>Administration Office</b>	As above
<b>Website - Consumer</b>	<a href="http://www.clericalmedical.co.uk">www.clericalmedical.co.uk</a>
<b>Website - IFA</b>	<a href="http://www.clericalmedical.co.uk">www.clericalmedical.co.uk</a>

## Key Personnel

Chief Executive Director	A G Kane
Managing Director	J van der Wielen
Finance Director	J McConville
Marketing Director	J Warburton
Customer Service Director	N Frankland
IT Director	P Penney
General Manager, Customer Services	A Harrison
Intermediaries Director	S Massey
Chief Actuary	A M Eastwood
With Profits Actuary	N A Holliday

## Company Background

The Clerical, Medical & General Life Assurance Society was established in 1824 to cater for the insurance needs of the professionals of the day - the clergy and medics. Clerical Medical has since broadened its target market to all types of professions and beyond this to a wider target market.

At the end of 1996, the Society converted to limited company status and joined the Halifax, with the Society's business being transferred to the newly formed CMIG. Historically a with profits company, most new business is now written on a unit linked basis. Unit linked pensions business is reinsured to its subsidiary CMMF.

In May 2006, much of Halifax Life's with profits business (previously reinsured with the company) transferred to CMIG.

## Overall Financial Strength

**B+**

Whilst free assets fell during 2008, the company retains adequate solvency as evidenced by the capital reduction and the payment of an enhanced dividend. Whilst the company now has the support of a much larger and stronger parent, certainly than latterly within HBOS, the decision to go forward under the Scottish Widows brand and primarily Scottish Widows products, in preference to Clerical Medical, will inevitably mean reduced new business levels and an accelerated run off. Some consolidation of companies within LBG seems inevitable and some disposals cannot be ruled out. The current environment will also bring with it reputational challenges, susceptibilities to political unpredictabilities given its part government ownership and the demands of a significant integration exercise.

## Reinsurance

### Approach

The company paid reinsurance premiums totalling £1.9bn in 2008 [2007: £2bn].

The company has a wide range of risk treaties in force.

Reinsurance is also used quite extensively within the group to transfer risks from one company to another. In particular, CMIG has reinsured substantial blocks (£9.7bn liabilities at the end of 2008, and £1.86bn premiums during 2008) of non-profit and unit linked pensions business to CMMF. The subsidiary bears no expense or mortality risk under this arrangement. The intra-group reinsurance explains the overwhelming majority of the 40% of gross reserves that are reinsured. The company reinsures in some £1.18bn of UWP business from Clerical Medical International. All of the company's non-profit pension annuity business, currently amounting to £1.6bn of liabilities, has also been reinsured to CMMF since the end of 2002.

<b>Analysis of Reserves</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
	<b>£000's</b>	<b>£000's</b>	<b>£000's</b>
Gross reserves	27,962,766	26,595,697	24,203,078
Reinsurance ceded - external	13,071	7,718	8,468
Reinsurance ceded - internal	10,256,165	11,095,517	9,733,546
Net mathematical reserves	17,693,530	15,492,462	14,461,063

## Non Profit Business

### General

Only a very small proportion of the company's business is written on a non profit basis.

The main product line relates to pensions annuities. This business, with gross liabilities of £1.6m, has been reinsured with CMMF since 2002. Almost 60% of retained non profit liabilities relates to overseas business. Net non profit reserves fell significantly in 2007 following the implementation of PS06/14.

<b>Non Profit Reserves</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
	<b>£000's</b>	<b>£000's</b>	<b>£000's</b>
UK Life	166,508	50,422	45,681
UK Pensions	98,099	40,955	50,375
Overseas	213,152	131,579	129,200
Total net NP reserves	477,759	222,956	225,256

### Non Profit Financial Strength

**★★★★★**

The company's non profit business appears to have significant protection, assuming that an appropriate level of potential support is available from its ultimate parent.

Non profit business held within CMMF is deemed to enjoy a similar level of security.

## Unit Linked Business

### Approach

Apart from a small number of group pension arrangements written directly into CMMF, all unit linked new business is written in CMIG, which at the end of 2008 had gross unit linked reserves of £11.25bn [2007: £13.2bn]. The pensions business is then almost all reinsured onwards to CMMF, so that the bulk of the linked liabilities reside in that company. Around £3.3bn of linked life liabilities remain in CMIG.

Clerical Medical repositioned its fund offerings for life and pensions products in the latter part of 2008 and followed this in 2009 with the launch of a range of Clerical Medical branded OEIC funds under the banner Clerical Medical Investment Solutions (CMIS), written in HBOS Investment Fund Managers Ltd. All these funds are available across all product wrappers, including ISAs, onshore and offshore bonds and pension. CMIS comprises three elements; an Investment Committee - a fund monitoring service, Portfolio Architect - a modelling tool, and CM Funds - an enhanced range of 36 funds with clear mandates. There are three investment approaches, namely Managed Funds, Targeted Return Funds, and Bespoke Funds. The majority of the CM funds are managed by Insight Investment management, with the Property Fund being managed by Invista Real Estate Management.

The company also offers access to a range of funds from six external fund managers: BGI, Fidelity, Invesco Perpetual, Newton, Schroders and UBS chosen using a strict set of criteria.

Linked Reserves	2006	2007	2008
	£000's	£000's	£000's
UK Life	3,292,392	3,424,667	2,838,729
UK Pensions	226,627	77,080	74,826
Overseas	178,421	349,583	458,637
Total net linked reserves	3,697,439	3,851,331	3,372,191

### Unit Linked Financial Strength

★★★★

Much of Clerical Medical's unit linked pension liabilities is reinsured to its CMMF subsidiary, but AKG considers that this should enjoy a similar level of support as its parent. Overall, the linked business appears to have reasonable protection, assuming that an appropriate level of potential support is available from its ultimate parent.

## With Profits Business

### Approach

Based on retained liabilities CMIG is predominantly a with profits company. The company maintains one with profits fund, in which there are a number of notional funds, containing both conventional and unutilised business together with business reinsured in from Clerical Medical International. UK with profits business is in decline with effectively no new business. Similarly overseas new business has declined significantly although the overseas funds shown below were boosted in 2008 by currency gains against sterling.

With Profit Reserves	2006	2007	2008
	£000's	£000's	£000's
UK Life	4,883,539	4,739,275	4,111,628
UK Pensions	3,884,624	3,300,274	2,890,036
Overseas	4,750,167	3,378,627	3,861,952
Total net WP reserves	13,518,331	11,418,175	10,863,616

### Profit Sharing Philosophy

The objectives of Clerical Medical's bonus policy are to return to each generation of policyholders their smoothed asset share, to provide equitable treatment between maturing and surrendered policies and to manage the proportions of bonus paid as terminal bonus at adequate levels to deal with fluctuations in investment market values.

### Asset Allocation

The with profits fund's EBR at December 2008 was 47.5% [2007: 67%] In addition, the fund also uses derivatives to give the fund some downside protection. There are different EBRs for offshore business in the fund, depending on currency.

Distribution of Surplus	2006	2007	2008
	£000's	£000's	£000's
To Policyholders	233,118	375,896	308,047
Other Transfers	46,742	9,290	8,813

### Realistic Balance Sheet

	2006	2007	2008
	£000's	£000's	£000's
Working capital	1,554,327	1,490,253	553,425
Risk capital margin	648,492	734,488	460,533
Realistic excess available	905,835	755,765	92,891
Working capital ratio	9.4%	10.3%	4.4%
RCM as % of assets	3.9%	5.1%	3.6%
Realistic xs available ratio	5.5%	5.2%	0.7%

Market movements meant working capital reduced substantially alongside another significant drop in the RCM.

### With Profits Financial Strength

★★★

Falling markets during 2008 saw the level of realistic capital fall sharply, notwithstanding a significant fall in the RCM, which continues to include a provision (£54m) for uncertainties in the data. The fund is effectively closed for UK new business and overseas new business is declining. Whilst the fund is secure it remains unclear as to the future of the fund given the ongoing merger within LBG and the possibility that parts of the enlarged group may be disposed of.

**Key Financial Data** (for y/e: 31/12/08)

<b>Capital Resources</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
	<b>£000's</b>	<b>£000's</b>	<b>£000's</b>
Core tier one capital	4,657,876	4,993,160	3,287,572
Tier one waivers	0	0	0
Other tier one capital	0	0	0
Tier one deductions	-551,550	-388,650	-294,716
Total tier one capital	4,106,326	4,604,510	2,992,856
Tier two capital	1,065,577	1,130,818	1,381,974
Adjustments and deductions	-431,992	-476,471	-816,638
Total Capital Resources	4,739,911	5,258,857	3,558,192
CR outside the fund	1,403,790	2,035,583	1,953,596

Available capital resources reduced in 2008, impacted by market falls and the payment of a dividend of £610m [2007: £204m]. The larger dividend was made possible by the decision during the year to reduce the company's issued share capital from £1.629bn to £70m.

The tier two capital of £1.3bn is subordinated debt, of which £900m is Upper Tier Two and the balance is Lower Tier Two. July 2009 saw the company redeem £617m of its subordinated debt. In addition there were inadmissible assets of £817m.

<b>Long Term Business Admissible Assets</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
	<b>£000's</b>	<b>£000's</b>	<b>£000's</b>
Fixed Interest	3,875,246	2,722,267	2,656,416
Equities	10,018,599	8,928,441	6,558,752
Property	2,235,307	1,912,888	1,251,933
Linked	3,483,162	3,830,656	3,374,066
Other	2,092,131	2,026,518	3,210,984
Total Assets	21,704,445	19,420,770	17,052,151

Long term assets fell again in 2008, primarily as a result of market falls.

<b>Free Assets</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
	<b>£000's</b>	<b>£000's</b>	<b>£000's</b>
Free Assets (Exc Fin Eng)	2,625,654	2,881,312	1,955,569
Financial Engineering	0	0	0
Free Assets (Published)	2,625,654	2,881,312	1,955,569

<b>Free Asset Ratios</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
	<b>%</b>	<b>%</b>	<b>%</b>
FAR (Exc Fin Eng)	12.1	14.8	11.5
FAR (Published)	12.1	14.8	11.5

<b>CRR Coverage Ratios</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
	<b>%</b>	<b>%</b>	<b>%</b>
CRRCR (Exc Fin Eng)	224.2	221.2	222.0
CRRCR (Published)	224.2	221.2	222.0

Free assets fell in 2008 driven by market falls, with a significant proportion of the published free assets showing an increased reliance on subordinated debt and other instruments. Overall CRR coverage was unchanged in 2008.

<b>Long Term Business Liabilities &amp; Margins</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
	<b>£000's</b>	<b>£000's</b>	<b>£000's</b>
Non Linked Non Profit	477,759	222,956	225,256
Non Linked With Profits	2,375,965	2,136,198	2,069,720
Accum'lg With Profits	11,156,929	9,302,242	8,809,824
Linked	3,697,439	3,851,331	3,372,191
Surplus c/f	694,973	576,815	438,633
Other liabilities	660,232	684,768	970,564
Investment Reserves	2,641,148	2,646,459	1,165,963
Total Liabilities/Margins	21,704,445	19,420,769	17,052,151

The majority of net liabilities are with profits due to the reinsurance of unit linked business into CMMF. The apparent run off of the with profits business slowed in 2008, helped by currency movements. The company has a sizeable exposure to guaranteed annuity options and has set aside a provision of £420m [2007: £500m]. In addition the company held a net provision of £95.4m in respect of uncertainties over asset and policy data, with a further £29m was held in CMMF.

<b>Key Revenue Items</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
	<b>£000's</b>	<b>£000's</b>	<b>£000's</b>
<b>INCOME</b>			
Premiums	1,147,396	1,192,965	947,051
Investment Income	868,517	703,493	699,930
Investment Increase	175,580	287,471	108,604
<b>EXPENDITURE</b>			
Commissions	178,762	176,304	155,100
Policy claims	4,039,113	3,529,066	2,468,686
Expenses	351,824	286,532	286,601
TRANSFER to P&L	300,000	500,000	250,000
INCREASE in fund	-2,564,281	-2,313,522	-1,173,918

Falling new business impacted premium income and even though claims and expenses also fell, the fund still saw a net outflow, albeit an improvement over 2007. Gross premiums fell by 12.1% whilst net premiums fell further, by 20.1%. Expenses, excluding commissions, were unchanged. Claims reduced again, helped by a 37% fall in surrenders, mostly in the with profits fund.

Transfers to the shareholder fund have exceeded £1bn in total in the past three years.

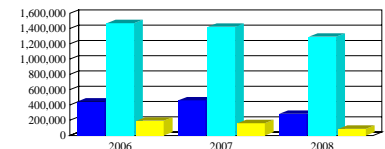
<b>Expense Ratios</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
New business (% APE)	48.0	48.3	54.0
Renewal (% reg premiums)	30.9	22.8	21.3
Renewal (% p.a. of mean fund)	1.37	1.25	1.32

Expenses, including commissions were down overall. The new business ratio increased following both a fall in new business and an increase in acquisition expenses. Whilst maintenance expenses increased again, the renewal ratios were helped by a further decrease in "Other" expenses.

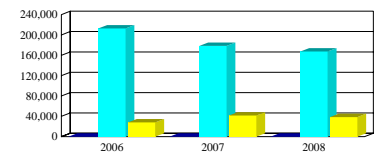
**New Business Data** (for y/e: 31/12/08)

	Single £000's	Regular £000's
<b>Investment</b>		
Bonds With Profits	0	0
Unitised WP	9,235	0
Unit Linked	361,162	0
Endowment With Profits	0	0
Unitised WP	0	3,668
Unit Linked	0	18,464
Guaranteed Bonds	0	0
ISA / tax exempt	0	0
Annuities	0	0
Miscellaneous	0	0
<b>Protection</b>		
Whole Life With Profits	0	0
Unitised WP	0	6,205
Unit Linked	900	10,384
Term Ordinary	0	0
Pension	0	50
IP Individual	0	0
Critical Illness	0	0
Long Term Care	0	0
Miscellaneous	0	0
<b>Pensions</b>		
Individual With Profits	0	0
Unitised WP	19,166	9,810
Unit Linked	1,081,709	96,562
CPA	122,035	0
Bulk Transfer Annuities	0	0
Miscellaneous	0	0
<b>Group Business</b>		
Pension	68,583	61,128
Life	0	0
IP	0	0
Critical Illness	0	0
Miscellaneous	0	0
<b>TOTAL DIRECT BUSINESS</b>	<b>1,662,790</b>	<b>206,271</b>
<b>Overseas Direct (inc above)</b>	<b>87,791</b>	<b>38,670</b>
<b>External Reins (exc above)</b>	<b>2,226</b>	<b>0</b>
<b>Intra-Group Reins (exc above)</b>	<b>46</b>	<b>0</b>
<b>Industrial Branch (inc above)</b>	<b>0</b>	<b>0</b>

New Single Premiums	2006 £000's	2007 £000's	2008 £000's
UK Life	443,715	459,906	283,506
UK Pensions	1,471,028	1,424,080	1,293,719
Overseas	194,128	160,778	87,791
<b>Total (Direct + External Reins)</b>	<b>2,108,871</b>	<b>2,044,764</b>	<b>1,665,016</b>
Growth Rate	-0.4%	-3.0%	-18.6%
Reins Accepted (Intra-Group)	871	42	46



New Regular Premiums	2006 £000's	2007 £000's	2008 £000's
UK Life	104	65	51
UK Pensions	212,723	178,514	167,550
Overseas	28,141	41,528	38,669
<b>Total (Direct + External Reins)</b>	<b>240,969</b>	<b>220,107</b>	<b>206,270</b>
Growth Rate	48.3%	-8.7%	-6.3%
Reins Accepted (Intra-Group)	59	0	0



The HBOS group as a whole is a major writer of savings and investment business in terms of APE, due in no small part to its bancassurance operation through Halifax Life and St Andrew's Life. Across the four life companies APE fell over 33% in 2008. Within this, HBOS reported a 17% fall in the value of bancassurance sales but a 6% rise in the value of intermediary sales. In APE terms, CMIG was the main contributor [£373m], followed by St Andrews Life [£253m] and Halifax Life [£106m].

Within CMIG, APE decreased by 12.2%. Within this, sales of unit linked bonds fell by 40%. Sales of pensions products, particularly single premiums, declined, as the A-Day effect petered out. Overseas business declined following a small revival in 2007. Sales of with profits bonds, which are now entirely overseas, fell over 60% to less than £10m.

## Corporate Data

<b>Ownership</b>	Lloyds Banking Group plc
<b>Open to New Business?</b>	Yes
<b>Year Established</b>	1981
<b>Key Personnel</b>	
Director	A G Kane
Director	J van der Wielen
Director	T A Leonard
Actuarial Function Holder	P Turnbull

## Company Background

The company was established in 1981 as Clerical Medical's specialist unit linked pensions subsidiary.

Originally, all business was written directly into the company, but the approach was changed in 1996, since when most business has been written in the immediate parent, Clerical Medical Investment Group Ltd, and reinsured to the company. The company's strategy of targeting small to medium pension schemes has expanded to encompass larger bespoke arrangements with the addition of a range of LDI pooled funds.

There is one major reinsurance treaty with Suffolk Life Annuities Ltd under which premiums of £28.6m were paid and reserves of £55.7m were ceded in 2008.

The company also has some onwards reinsurance from Halifax Life in respect of business reinsured to that company from Equitable Life.

## Overall Financial Strength

**B+**

Whilst solvency improved during 2008 during the year, the company reported a loss after tax of £14.4m [2007: £15.4m]. Both the free asset ratio and CRR coverage remained acceptable for a non profit/unit linked operation. The company has a subordinated loan from CMIG of £100m dating from 2005. Net premium income for the year reduced to £1.9bn [2007: £2.sbn].

Whilst the company was an integral part of Clerical Medical's overall proposition, it remains to be seen what impact the acquisition of HBOS by Lloyds will have as integration and any potential restructuring takes place.

## Key Financial Data (for y/e: 31/12/08)

<b>Long Term Business Admissible Assets</b>	<b>2006 £000's</b>	<b>2007 £000's</b>	<b>2008 £000's</b>
Fixed Interest	1,749,242	1,872,833	1,874,833
Equities	71,025	4,088	150,281
Property	0	0	0
Linked	13,429,611	13,744,672	12,488,627
Other	403,926	323,593	36,713
<b>Total Assets</b>	<b>15,653,804</b>	<b>15,945,186</b>	<b>14,550,454</b>

<b>Free Assets</b>	<b>2006 £000's</b>	<b>2007 £000's</b>	<b>2008 £000's</b>
Free Assets (Exc Fin Eng)	204,385	154,666	191,732
Financial Engineering	0	0	0
<b>Free Assets (Published)</b>	<b>204,385</b>	<b>154,666</b>	<b>191,732</b>

<b>Free Asset Ratios</b>	<b>2006 %</b>	<b>2007 %</b>	<b>2008 %</b>
FAR (Exc Fin Eng)	1.3	1.0	1.3
FAR (Published)	1.3	1.0	1.3

<b>CRR Coverage Ratios</b>	<b>2006 %</b>	<b>2007 %</b>	<b>2008 %</b>
CRRCR (Exc Fin Eng)	283.9	209.3	237.5
CRRCR (Published)	283.9	209.3	237.5

<b>Long Term Business Liabilities &amp; Margins</b>	<b>2006 £000's</b>	<b>2007 £000's</b>	<b>2008 £000's</b>
Non Linked Non Profit	2,055,741	2,131,909	1,965,982
Non Linked With Profits	0	0	0
Accum'lg With Profits	0	0	0
Linked	13,429,801	13,726,820	12,438,440
Surplus c/f	44,577	48,415	71,180
Other liabilities	123,683	38,041	74,853
Investment Reserves	0	0	0
<b>Total Liabilities/Margins</b>	<b>15,653,803</b>	<b>15,945,185</b>	<b>14,550,455</b>

## New Business Data (for y/e: 31/12/08)

<b>New Single Premiums</b>	<b>2006 £000's</b>	<b>2007 £000's</b>	<b>2008 £000's</b>
UK Life	0	0	0
UK Pensions	152,560	163,280	83,238
Overseas	0	0	0
<b>Total (Direct + External Reins)</b>	<b>152,560</b>	<b>163,280</b>	<b>83,238</b>

Growth Rate	-6.3%	7.0%	-49.0%
Reins Accepted (Intra-Group)	1,357,701	1,389,208	1,266,117

<b>New Regular Premiums</b>	<b>2006 £000's</b>	<b>2007 £000's</b>	<b>2008 £000's</b>
UK Life	0	0	0
UK Pensions	0	0	0
Overseas	0	0	0
<b>Total (Direct + External Reins)</b>	<b>0</b>	<b>0</b>	<b>0</b>

Growth Rate			
Reins Accepted (Intra-Group)	194,250	176,905	159,289

## Distribution

### Method

Now as part of the Lloyds Banking Group (following its acquisition of HBOS), the products of Clerical Medical are distributed under the Scottish Widows brand in the intermediary market, through a combined Scottish Widows branded salesforce.

As part of this integration, a swathe of Clerical Medical products were removed from intermediary distribution, being 'replaced' by their Scottish Widows alternatives. Clearly Scottish Widows intermediary distribution now has the opportunity to cement a more significant footprint in terms of intermediary market share, afforded it by the integration of Clerical Medical. Post integration Scottish Widows has 136 face to face account managers and 46 telephone based account managers in the intermediary channel. In addition it has 19 managers, 13 key account managers and 11 investment specialists. This capability, along with a greater use of account segmentation, positions the combined operation well, albeit subject to an overarching requirement for a smooth integration within the wider business, which will be challenging.

The group is yet to finalise and announce plans for the bancassurance channel in terms of integration and product/brand usage. albeit this will primarily concern the future operations of Halifax Life and St Andrew's Life.

Distribution Split	Regular Premium %	Single Premium %
IFAs	99.0	99.0
Multi-Ties	1.0	1.0

### Image and Strategy



HBOS had undertaken a restructuring of its life and pensions business, which led to a sharing of a number of back office functions. Whilst the bancassurance nature of the group increased in recent years, Clerical Medical was brought closer to the parent in management and strategic terms.

To a significant extent, however, this was overtaken by adverse conditions experienced by the HBOS parent in its core banking operations. These well documented difficulties led to governmental intervention and the takeover by Lloyds TSB to form Lloyds Banking Group. This led to the requirement for integration of the insurance and investment businesses of the two banking groups. This is ongoing. However, July 1st saw a single intermediary sales force launched under the Scottish Widows brand.

The integration of the HBOS life companies into the Lloyds Banking Group insurance and investment operation, brings with it major challenges. Further, the background environment includes the banking crisis and credit crunch, which has seen governmental involvement in the Lloyds Banking Group amongst other things and, in general, a further erosion in confidence and respect for the banking sector in the public consciousness. Disposals of parts of the enlarged business cannot be ruled out.

## Products

### Overall Product Philosophy

Prior to the takeover by Lloyds, Clerical Medical concentrated on investment and individual pension products, with a focus on product flexibility. It operated mainly as a with profits company but more recently the majority of new business has been written on a unit linked basis, with some overseas business still written on a with profits business.

Following the merger, new business into Clerical Medical is now limited to OEICS and ISAs (written into HBOS Investment Fund Managers Ltd) and onshore bonds. These will be available via the Scottish Widows brand,

Whilst the company no longer writes group pensions business it does accept increments and new members to existing schemes.

In addition to the CMIG and CMMF long term products marketed under the Clerical Medical brand, detailed below, the CMI offshore company writes offshore bonds (Global and Corporate Investor).

### Products Currently Marketed

#### Investment Products

Written in Clerical Medical Investment Group Ltd  
Unit Linked Bonds  
With Profit Bonds (increments only)

## Service



### Approach

HBOS had been active in developing a single customer service ethos, which in terms of its practical delivery uses common workflow solutions, processes and working practices. This was based on what the organisation encapsulates as its "5 C's", namely Customers, Colleagues, Cost, Compliance and Change.

The last of these had seen significant focus over the last few years as the organisation had sought to make a step change in its operational delivery and is now seeing the positive results of this. Metrics now indicate a better position and importantly a more consistent one.

In terms of the customer segment, the operation now utilises the six sigma methodology to drive improvements. A process also used by Scottish Widows.

The organisation has also demonstrated a good connectivity between its service and retention initiatives within an overarching context of its TCF focus. Indeed with regard to TCF, progress has appeared to continue, despite the more difficult operating environment and uncertainty. There has been requisite involvement of the leadership team, together with implementation of TCF champions for each work team.

Clearly the ongoing integration with Scottish Widows is a dominant element in the service shape. In the short term this is resulting in the reduction in sites and consequent movement and downsizing of staff numbers, as well as alignment of reporting with Scottish Widows.

### e-Business

Further enhancements to its e-commerce facilities to increase efficiency and improve service quality are planned, drawing on experience from both organisations.

### Service Standards & Awards

Clerical Medical's service reputation has proved somewhat erratic in recent years. Previously enjoying a good reputation for service, this started to slip in 2002 and is yet to fully recover. Part of the strategic review in 2006 was aimed at driving through a step change in service performance and with internal metrics indicating some success in this, it will be interesting to see how measures of external perception correlate in the future.

As regards Scottish Widows, it recovered its service reputation following a temporary blip post-demutualisation. Following a number of poor years Scottish Widows has since achieved some of the highest ratings in industry service awards.

### Outsourcing

The final shape and extent of outsourcing will be decided by the integration activity with Scottish Widows and the strategy followed by the new Lloyds Banking Group.

The Lloyds TSB Group had a programme of outsourcing and offshoring a number of its processing and back office operations, primarily overseas, using the third party provider Xansa, which is already part of its infrastructure in India.

## Investment

### Overall Approach

Funds are currently managed by the sister company, Insight Investment Management Ltd.

Property investments are managed by Invista Real Estate Management (a company spun out of Insight in September 2006). Invista manages both commercial and residential property across the UK and continental Europe, and had a total of £5.5bn of assets under management as at the end of May 2009.

Active fund management across all major classes is a central theme. Fundamental research is combined with fund manager experience. Working as a team, but with individual accountability, the aim is to add value over the long-term, allowing for the economic cycle, within a disciplined framework. Excellent customer service is a priority.

In August 2009 LBG announced that it had agreed to sell Insight to BNY Mellon for £235m, following which the management of Clerical Medical funds, currently managed by Insight, will switch to Scottish Widows Investment Partnership (SWIP).

### Funds Under Management

At the end of 2008 CMIG had £17bn of long term assets [2007: £19.4bn], the majority of which related to with profits business. There was a further £14.5bn in Clerical Medical Managed Funds. Insight Investment Management funds under management stood at £117bn at March 2009.

## Annual Review



2008 saw new business within CMIG continue its gradual downward trend. The result was that both CMIG and its subsidiary CMMF again saw a net outflow of funds on lower premium income, reflecting the continuingly difficult market conditions during the year.

However, the year was very much overshadowed by the decision by Lloyds TSB to takeover HBOS. Given the extensive range of insurance companies and brands within the enlarged group, this naturally led to some uncertainty as to how the group might emerge post any consolidation. Early 2009 saw the group confirm that it would retain the Scottish Widows brand within the intermediary space in preference to, and effectively dropping over time, the Clerical Medical brand. The group operates from 1st July 2009 with a combined single branded sales force. It is as yet not clear how the various corporate entities will fare in the consolidation, an exercise that may take some years to finally complete. There is real potential for economies of scale and the merger has the potential to create a massive bancassurance player, notwithstanding its intermediary presence.

## Financial Strength Ratings - Introduction

The aim of AKG's financial strength ratings is to assist IFAs and others to assess the relative strengths of individual provider companies. AKG's concept of 'financial strength' starts with the fundamental issue of a company's ability to meet all of its guaranteed payments to policyholders, but extends beyond this by aiming to factor in the degree to which a policyholder's expectations are likely to be met - or even exceeded - in the long-term. For performance-related products, where the eventual return generally depends largely upon a company's success in consistently delivering superior investment performance, and in containing expense charges, a company's ability to meet expectations is likely to be heavily dependent upon whether or not it is able to sustain its operations in the relevant market, and whether or not it can maintain, or improve, its competitive position.

As a result, AKG believes that, ideally, the evaluation of 'financial strength' should depend upon the type of product under consideration. A particular company may be judged as very strong in the context of one particular product line, but it may be weaker in another context. An illustration of this concept is a company that currently only markets unit linked business, but which has a very small closed block of with profits business, written many years ago. Such a company may be judged as 'good' for unit linked business, whilst considered 'poor' in respect of with profits business.

Since the inception of AKG's Company Profiles and Financial Strength Reports, AKG has consistently promoted and developed the concept of providing financial strength ratings separately for each of the three major product categories - With Profits, Non Profit and Unit Linked.

All AKG's financial strength ratings should be used with care, since even the more detailed approach described above represents something of a simplification. To illustrate this point, for example, the 'Non Profit' category covers a multiplicity of different products. It is clear that slightly different criteria should be used for, say, short-term policies with fully guaranteed terms (e.g. Guaranteed Bonds), than for longer-term policies with terms that can be varied at the company's discretion (e.g. Renewable or Reviewable Term).

AKG assesses financial strength using consistent methodology and objective measures wherever possible, and based on the detailed analysis of the company's particular strengths and weaknesses. The objectives and criteria for each of the financial strength ratings are summarised below:

### With Profits Financial Strength Rating

The objective is to assess the overall strength of the company's with profits funds. The initial concern is the company's ability to meet its ongoing guaranteed, or promised, commitments, i.e. existing sum assured and bonuses. However, the company's ability to continue to compete successfully in the with profits market is also particularly relevant, given that closed funds are sometimes bad news for policyholders. In such situations, overall expenses tend to increase as a proportion of the fund and investment performance may well deteriorate. These, together with other factors, may make it difficult for companies in such situations to maintain competitive bonus rates at future declarations, although existing declared bonuses are not affected (other than possibly by MVRs).

The main criteria taken into account are: capital base and free asset position, with profits realistic balance sheet position, the amount of with profits business in-force, parental strength (and likely attitude towards supporting the company), and image and strategy.

NOTE: More detailed analysis of with profits companies is included in AKG's UK Life Office With Profits Report.

★★★★★	Excellent
★★★★	Very good
★★★	Good
★★	Adequate
★	Poor
☐	Not rated

### Non Profit Financial Strength Rating

The objective is to assess the company's ability to meet all guaranteed payments arising from such contracts as term plans, annuities etc.

The main criteria taken into account are: free assets, structure (and size) of funds within the company, parental strength (and likely attitude towards supporting the company), and image and strategy.

★★★★★	Excellent
★★★★	Very good
★★★	Good
★★	Adequate
★	Poor
☐	Not rated

## Unit Linked Financial Strength Rating

Whilst this is essentially a non profit line, and the primary objective is to assess the company's ability to meet all guaranteed payments arising, AKG also seeks to take into account the extent to which the company is likely to be able to sustain its unit linked operations, and whether or not it is likely to be able to maintain, or improve, its competitive position. Thus strategic issues are also relevant, because of their bearing on the quality of investment management offered, and because of companies' rights to increase charges etc.

The main criteria taken into account are: free assets, structure (and size) of funds within the company, parental strength (and likely attitude towards supporting the company), typical fund performance achievements, and image and strategy.

★★★★★	Excellent
★★★★	Very good
★★★	Good
★★	Adequate
★	Poor
☐	Not rated

## Overall Financial Strength Rating

The objective is to provide a simple broad-brush indication of the general financial strength of a company. In addition to an assessment of the company's ability to meet all of its guaranteed payments to policyholders, AKG also aims to factor in the degree to which policyholders' expectations are likely to be met - or even exceeded - in the long-term. This involves an assessment of a company's ability to survive in its current form for the long term. The overall rating inherently reflects the mix of business in-force within the company, since different types of policyholder have different expectations, and the company's particular strengths and weaknesses in respect of its key product areas.

The rating takes into account those of the following criteria which are relevant (depending upon the company's mix of business in-force): capital base and free asset position, with profits realistic balance sheet position, structure (and size) of funds within the company, parental strength (and likely attitude towards supporting the company), typical fund performance achievements, and image and strategy.

A	Superior
B+	Very strong
B	Strong
B-	Satisfactory
C	Weak
D	Very Weak

## Supporting Ratings - Introduction

**Supporting ratings are provided only in full reports, and are assessed at the brand level. AKG assesses three key supporting areas, using consistent methodology and objective measures wherever possible. The aim is to assist IFAs and others to consider the relative merits of the brands that they deal with. AKG's objectives and criteria for each of these ratings are summarised below:**

### Service Rating

The objective is to assess the quality of the organisation's service to the intermediary market in respect of the brand concerned.

Criteria taken into account include: performance in surveys, awards and benchmarking exercises (external and internal), the organisation's philosophy, service charters, the extent of investments designed to improve service, and feedback from intermediaries.

★★★★★	Excellent
★★★★	Very good
★★★	Good
★★	Adequate
★	Poor
☐	Not rated

### Image and Strategy Rating

The objective is to assess the effectiveness of the means by which the organisation currently positions itself to distribute its products for the brand concerned and the plans it has to maintain and/or develop its position.

Criteria taken into account include: overall trends in the company's market share position, brand visibility and reputation, feedback from intermediaries and industry commentators, and AKG's view of the company's general strategy.

★★★★★	Excellent
★★★★	Very good
★★★	Good
★★	Adequate
★	Poor
☐	Not rated

### Annual Review Rating

This is an end of year view for the last year for which Report and Accounts, returns to the FSA, etc., are available, together with comment on any significant post-balance sheet events. It is an assessment of how the brand has fared against its peers, and how it is perceived externally.

Criteria taken into account include: increase/decrease in market shares, expense containment, publicity - good or bad, press or market commentary, regulatory fines, and competitive position.

★★★★★	Excellent
★★★★	Very good
★★★	Good
★★	Adequate
★	Poor
☐	Not rated

The logo for AKG, consisting of the letters 'AKG' in a bold, black, sans-serif font.

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AKG is an actuarially based consultancy specialising in the provision of information and market assistance to the financial services industry

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