

**CLERICAL MEDICAL FINANCE PLC**

**DIRECTORS REPORT  
AND  
FINANCIAL STATEMENTS**

**31 DECEMBER 2010**

Member of Lloyds Banking Group plc

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**COMPANY INFORMATION**

**Board of Directors**

J Clatworthy  
K Luscombe

**Secretary**

S Mayer

**Auditors**

PricewaterhouseCoopers LLP  
31 Great George Street  
Bristol  
BS1 5QD

**Registered Office**

33 Old Broad Street  
London  
EC2N 1HZ

**Company Number**

3850542

**DIRECTORS' REPORT****Principal activities and review of the business**

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

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

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

*Redemption of subordinated debt (2009)*

During 2009, LBG undertook a series of transactions to improve its overall regulatory capital structure. One of these transactions involved the Company redeeming subordinated debt with a nominal value of £707.7m. As a result of this transaction the Company recognised a profit in the year ended 31 December 2009 of £261.1m.

**Results and dividend**

The result of the Company for the year ended 31 December 2010 is a profit after tax of £0.2m (2009: profit of £263.4m), and this has been transferred to reserves. No interim dividend was paid during the year (2009: £260.0m). The Directors do not recommend the payment of a final dividend (2009: £nil).

The carrying value of the subordinated assets at the year end was £567.4m (2009 £583.3m). The decrease is due mainly to foreign exchange movements during the year on Euro-denominated loans to CMIG. Interest income receivable on the subordinated debt as a percentage of the average subordinated debt in the year was 5.21% (2009: 5.71%).

The carrying value of the subordinated liabilities at the year end was £571.1m (2009: £586.9m). The decrease is due mainly to foreign exchange movements during the year on Euro-denominated subordinated debt. The interest expense payable on the subordinated liabilities as a percentage of the average subordinated liabilities in the year was 5.16% (2009: 5.69%).

*Key performance indicators*

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

**Future outlook**

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

**Principal risks and uncertainties**

The management of the business and the execution of the Company's strategy are subject to a number of risks. The financial risk management objectives and policies of the Company and the exposure to market risk, credit risk, and financial soundness risk are set out in note 14.

**Directors**

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

J Clatworthy	Appointed 1 January 2011
K Luscombe	Appointed 28 May 2010
T A Leonard	Resigned 31 December 2010
J Van Der Wielen	Resigned 28 May 2010

Particulars of the Directors' emoluments are set out in note 15.

All of the Directors (2009: none) have the benefit of a contract of indemnity which constitutes a "qualifying third party indemnity provision". This contract came into force during the financial year and remains in force. The contracts are available for inspection at the registered office of Lloyds Banking Group plc. Details of the registered office are given in note 15.

**DIRECTORS' REPORT (continued)****Disclosure of information to auditors**

Each Director confirms that, as far as they are aware, there is no relevant audit information of which the Company's auditors are unaware. Relevant information is defined as "information needed by the Company's auditors in connection with preparing their report".

Each Director has taken steps that he ought to have taken in his duty 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.

**Re-appointment of auditors**

Pursuant to section 487 of the Companies Act 2006, auditors duly appointed by the members of the Company shall, subject to any resolution to the contrary, be deemed to be reappointed for the next financial year and PricewaterhouseCoopers LLP will therefore continue in office.

**Policy and practice on payment of creditors**

The Company follows "The Better Payment Practice Code" published by the Department for Business Innovation and Skills ("BIS"), regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from the BIS, No1 Victoria Street, London, SW1H 0ET.

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 agreed terms of payment, provided the supplier performs according to the terms of contract.

The processing of invoices from suppliers and settlement of trade creditors is undertaken by a separate company within LBG. The number of days shown in this report, to comply with the provisions of the Companies Act 2006, is 14 days (2009: 20 days).

**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 elected to prepare 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;
- 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.

Each of the Directors, whose names are listed on page 3, confirm that, to the best of their knowledge:

- the Company financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Company; and
- the Directors' Report on pages 4 to 5 includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that it faces.

On behalf of the Board of Directors

S Mayer  
Secretary  
13 April 2011

**INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF CLERICAL MEDICAL FINANCE PLC**

We have audited the financial statements of Clerical Medical Finance plc for the year ended 31 December 2010 which comprise the Statement of Comprehensive Income, the Balance Sheet, the Statement of Cash Flows, the Statement of Changes in Equity, the Accounting Policies 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 5, 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 members 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.

**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 2010 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.

Joanne Leeson (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
Bristol

13 April 2011

## STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2010

	Note	2010 £ 000	2009 £ 000
<b>Revenue</b>			
Interest income on loans	2	30,923	55,575
Profit on release of subordinated debt		-	261,077
<b>Total revenue</b>		<b>30,923</b>	<b>316,652</b>
<b>Expenses</b>			
Interest payable on subordinated debt	4	29,979	51,234
Amortisation of finance costs on subordinated debt		686	1,051
Other expenses	3	41	103
<b>Total expenses</b>		<b>30,706</b>	<b>52,388</b>
<b>Profit before tax</b>		<b>217</b>	<b>264,264</b>
Taxation	5	(61)	(892)
<b>Profit for the year</b>		<b>156</b>	<b>263,372</b>

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

The notes set out on pages 11 to 25 are an integral part of these financial statements.

## BALANCE SHEET AS AT 31 DECEMBER 2010

	Note	2010 £ 000	2009 £ 000
<b>ASSETS</b>			
Financial assets:			
Loans receivable	6	567,362	583,270
Other receivables	7	23,546	23,678
Cash and cash equivalents	8	62	64
<b>Total assets</b>		<b>590,970</b>	<b>607,012</b>
<b>EQUITY AND LIABILITIES</b>			
<b>Capital and reserves attributable to Company's equity shareholder</b>			
Share capital	9	225	225
Retained earnings		4,585	4,429
<b>Total equity</b>		<b>4,810</b>	<b>4,654</b>
<b>Liabilities</b>			
Financial liabilities:			
Loans payable	11	571,091	586,908
Other financial liabilities	12	15,008	14,558
Current tax payable	13	61	892
<b>Total liabilities</b>		<b>586,160</b>	<b>602,358</b>
<b>Total liabilities and equity</b>		<b>590,970</b>	<b>607,012</b>

Approved by the Board on 13 April 2011

K Luscombe  
Director

The notes set out on pages 11 to 25 are an integral part of these financial statements.

## STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2010

	Note	2010 £ 000	2009 £ 000
<b>Cash flows from operating activities</b>			
Profit before tax		217	264,264
Adjusted for:			
Amortisation of finance costs on subordinated debt		686	1,051
Profit on release of subordinated debt		-	(261,077)
Movement in loans receivable		15,908	706,883
Movement in subordinated guaranteed bonds		(16,503)	(441,785)
Movement in other receivables		132	6,315
Movement in other liabilities		450	(15,667)
Taxation paid		(892)	(143)
<b>Net cash (outflows)/inflows from operating activities</b>		<b>(2)</b>	<b>259,841</b>
<b>Cash flows from financing activities</b>			
Dividends paid		-	(260,000)
<b>Net cash flows from financing activities</b>		<b>-</b>	<b>(260,000)</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(2)</b>	<b>(159)</b>
Cash and cash equivalents at the beginning of the year		64	223
<b>Net cash and cash equivalents at the end of the year</b>	<b>8</b>	<b>62</b>	<b>64</b>

The notes on pages 11 to 25 form an integral part of these financial statements.

## STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2010

	Notes	Issued share capital £ 000	Retained earnings £ 000	Total £ 000
<b>Balance as at 1 January 2009</b>		<b>225</b>	<b>1,057</b>	<b>1,282</b>
Total comprehensive income for the year		-	263,372	263,372
Dividends paid	10	-	(260,000)	(260,000)
<b>Balance as at 31 December 2009</b>		<b>225</b>	<b>4,429</b>	<b>4,654</b>
Total comprehensive income for the year		-	156	156
<b>Balance as at 31 December 2010</b>		<b>225</b>	<b>4,585</b>	<b>4,810</b>

The notes on pages 11 to 25 form an integral part of these financial statements

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

**1. Accounting policies****Summary of significant accounting policies**

The Company has identified the accounting policies that are most significant to its business operations and the understanding of its results.

The financial statements comprise the statement of comprehensive income, the balance sheet, the statement of cash flows and the statement of changes in equity, as well as the related notes. The preparation of financial statements necessitates the use of estimates and assumptions in applying the accounting policies set out on pages 11 to 14. The accounting policies on impairment and classification of loans payable (note 1 (j) and note 1 (l)) involve the most complex or subjective decisions or assessments. These estimates and assumptions affect the reported amount of assets and liabilities, contingent or otherwise, at the reporting date as well as affecting the reported income and expenses for the year.

In each case, the determination of these is fundamental to the financial results and position of the Company, and requires management to make complex judgments based on information and financial data that may change in future periods. Although the estimates are based on management's best knowledge of current facts as at the reporting date, the actual outcome may differ from those estimates.

The significant accounting policies adopted in the preparation of the financial statements, which have been consistently applied to all periods presented in these financial statements, are set out below.

**(a) Basis of preparation**

The financial statements have been prepared:

(1) in accordance with the International Accounting Standards ("IASs") and International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board and the Standards and Interpretations ("SICs") and International Financial Reporting Interpretations ("IFRICs") issued by its International Financial Reporting Interpretations Committee, as endorsed by the European Union;

(2) in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRSs; and

(3) under the historical cost convention, as modified by the revaluation of certain financial assets and financial liabilities as set out in the relevant accounting policies.

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.

In accordance with IAS 1 "Presentation of Financial Statements", assets and liabilities in the balance sheet are presented in accordance with management's estimated order of liquidity. Analysis of the assets and liabilities of the Company into amounts expected to be received or settled within 12 months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in the notes.

**Standards and interpretations effective in 2010**

The Company has adopted the following new standards and amendments to standards which became effective for financial years beginning on or after 1 January 2010. None of these standards or amendments has had a material impact on these financial statements.

(i) *Improvements to IFRSs* (issued April 2009). Sets out minor amendments to IFRS standards as part of the annual improvements process.

Details of those IFRS pronouncements which will be relevant to the Company but which were not effective at 31 December 2010 and which have not been applied in preparing these financial statements are given in note 16.

**(b) Foreign currency translation**

The financial statements are presented in sterling which is the Company's functional and presentation currency.

Foreign currency transactions are translated into sterling at the exchange rate prevailing at the date of the transaction.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

**1. Accounting policies (continued)**

Financial assets and liabilities denominated in foreign currencies are translated at balance sheet date exchange rates. Exchange gains and losses are recognised in the statement of comprehensive income as incurred, within other income or other expenses.

**(c) Interest income**

Interest income consists of interest receivable on subordinated assets. Interest income is recognised in the income statement as it accrues, using the effective interest method.

**(d) Dividends**

Dividends are recognised in the period in which the right to receive payment is established.

**(e) Expense recognition**

Operating costs are recognised in the statement of comprehensive income as incurred, within other expenses.

**(f) Financial assets and financial liabilities**

Management determines the classification of its financial assets and financial liabilities at initial recognition and re-evaluates this at every reporting date. 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 cashflows 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 and financial liabilities are designated at fair value through income, with the exception of certain loans and receivables and other financial liabilities which are stated at amortised cost (as described in note 1 (h) and note 1 (m) below).

No assets are classified as held-to-maturity, available-for-sale or for trading; no liabilities are classified as held for trading.

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.

**(g) Taxes**

Tax on the profit or loss for the year is recognised in the statement of comprehensive income within taxation and comprises current and deferred tax.

Current tax

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

Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that, at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date.

Deferred income tax assets are only recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences, carry-forward of unused tax assets and unused tax losses can be utilised.

The carrying amount of deferred income tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the deferred income tax asset to be utilised.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

**1. Accounting policies (continued)****(h) Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Loans and receivables are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost, subject to impairment, with the exception of accrued interest, which is accounted for at fair value, reflecting the amounts receivable at the year end.

A charge for impairment in respect of loans and receivables would be made in the statement of comprehensive income when there is objective evidence that the Company will not be able to collect all amounts due according to their original terms. The impairment charge would be recognised in that part of the statement of comprehensive income in which the original transaction was reported. Further information on the Company's impairment policy is set out at note 1 (j).

**(i) Cash and cash equivalents**

Cash and cash equivalents includes cash at bank, short-term, highly liquid investments with original maturities of three months or less and bank overdrafts where a legal right of set off exists.

**(j) Impairment**Financial assets

The carrying value of all financial assets held at amortised cost is reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. The identification of impairment and the determination of recoverable amounts is an inherently uncertain process involving various assumptions and factors, including the financial condition of the counterparty, expected future cash flows, observable fair prices and expected net selling prices.

In order to determine whether financial assets are impaired, all financial assets for which the fair value has been significantly below the recoverable amount (assessed using cost price and the factors above) either by a significant amount or for a prolonged period of time are individually reviewed. A distinction is made between negative revaluations due to general market fluctuations and due to issuer-specific developments. The impairment review focuses on issuer-specific developments regarding financial condition and future prospects, taking into account the intent and ability to hold the securities under the Company's long term investment strategy.

Non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

If there is objective evidence that an impairment loss has occurred, the amount of the loss is charged to the relevant line in the statement of comprehensive income in the period in which it occurs.

Impairment process

Objective evidence that an asset or group of assets is impaired includes observable data that comes to the attention of the Company about the following events:

- (i) significant financial difficulty of the issuer or debtor;
- (ii) a breach of contract;
- (iii) the disappearance of an active market for that asset because of financial difficulties; or
- (iv) observable data indicating that there is a measurable decrease in the estimated future cashflow from a group of assets since the initial recognition of those assets, even where the decrease cannot yet be identified with the individual assets of the Company, including:
  - adverse changes in the payment status of issuers or debtors; or
  - national or local economic conditions that correlate with defaults on the assets in the Company.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

**1. Accounting policies (continued)**

The Company first assesses whether objective evidence of impairment exists individually for assets that are individually significant. If the Company determines that no objective evidence of impairment exists for an individually assessed asset, whether significant or not, it includes the asset in a group of assets with similar credit risk characteristics and collectively assesses them for impairment. Those characteristics are relevant to the estimation of future cashflows for such groups as they are indicative of the issuers' ability to pay all amounts due under the contractual terms of the debt instrument being evaluated. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

**(k) 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.

**(l) Loans payable**

Loans payable (which include deposits from banks, customer accounts, debt securities in issue and subordinated liabilities) are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently stated at amortised cost using the effective interest method.

The subordinated guaranteed bonds are classified as a liability on the basis of the existence of a capital disqualification event considered to be a genuine settlement provision in the context of current uncertainty surrounding the direction of future regulatory rule developments.

**(m) Other financial liabilities**

Other financial liabilities are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost. In practice, the carrying value of these balances equates to the fair value due to the short-term nature of the amounts included within other financial liabilities.

**(n) Effective interest rate**

Revenue on financial instruments classified as loans and receivables and expense on financial liabilities at amortised cost, are recognised on an effective interest rate basis. This calculation takes into account interest received or paid and fees and commissions paid or received that are integral to the yield as well as incremental transaction costs and all other premiums and discounts. The effective interest rate is the rate that discounts the expected future cash flows over the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial instrument at initial recognition.

**2. Interest income on loans**

	2010 £ 000	2009 £ 000
Interest receivable on loans	30,923	55,575
<b>Total</b>	<b>30,923</b>	<b>55,575</b>

**3. Other expenses**

	2010 £ 000	2009 £ 000
Loss on foreign currency exchange	39	103
Management charges	2	-
<b>Total</b>	<b>41</b>	<b>103</b>

No staff are employed directly by the Company (2009: none). All staff providing services to the Company are employed by other subsidiaries of LBG.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

## 3. Other expenses (continued)

Audit fees are borne by another subsidiary within LBG and are as follows:

	2010 £	2009 £
Fees payable for the audit of the Company's current year annual report	7,318	5,885
Fees payable for other services:		
Reporting returns for the Company	4,878	3,923
	<b>12,196</b>	<b>9,808</b>

## 4. Interest payable on subordinated debt

	2010 £ 000	2009 £ 000
Interest payable on bonds issued	29,979	51,234
<b>Total</b>	<b>29,979</b>	<b>51,234</b>

## 5. Taxation

## a) Current year tax charge

	2010 £ 000	2009 £ 000
Current Tax:		
UK Corporation tax	(61)	(892)
<b>Total</b>	<b>(61)</b>	<b>(892)</b>

## b) Reconciliation of tax charge

	2010 £ 000	2009 £ 000
<b>Profit before tax</b>	217	264,264
<b>Tax at 28% (2009: 28%)</b>	(61)	(73,994)
Effects of:		
Tax exempt income	-	73,102
<b>Total charge</b>	<b>(61)</b>	<b>(892)</b>

## 6. Loans receivable

	2010 £ 000	2009 £ 000
Amounts owed by group undertakings	567,362	583,270
<b>Total</b>	<b>567,362</b>	<b>583,270</b>

The receivables relate to funds deposited with CMIG. The deposits bear nominal interest between 4.27% and 7.61% depending on the terms of the specific deposit. Further information in respect of amounts owed by group undertakings is given in note 15.

The balances above include £8.5m (2009: £8.2m) due from CMIG in respect of amortised transaction costs. These amounts were previously disclosed within Other receivables.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

## 7. Other receivables

	2010 £ 000	2009 £ 000
Accrued interest receivable	17,582	17,714
Other amounts owed by group undertakings	5,964	5,964
<b>Total</b>	<b>23,546</b>	<b>23,678</b>

The above receivables are owed by group undertakings. Further information in respect of amounts owed by group undertakings is given in note 15.

## 8. Cash and cash equivalents

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

	2010 £ 000	2009 £ 000
Cash at bank	62	64
<b>Total</b>	<b>62</b>	<b>64</b>

## 9. Share capital

	2010 £ 000	2009 £ 000
<b>Authorised share capital:</b>		
225,000 ordinary shares of £1 each	225	225
<b>Allotted, called up and fully paid share capital:</b>		
225,000 ordinary shares of £1 each	225	225

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

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

## 10. Dividends

The following dividends were proposed and paid during the year:

	2010 £ 000	2009 £ 000
£nil per qualifying ordinary share (2009: £1,155.56 per share)	-	260,000

## 11. Loans payable

This note provides information about the contractual terms of the Company's interest-bearing loans and borrowings. For more information about the Company's exposure to interest rate and foreign currency risk, see note 14.

	2010 £ 000	2009 £ 000
<b>Non-current liabilities</b>		
Subordinated guaranteed bonds	571,091	586,908
<b>Total</b>	<b>571,091</b>	<b>586,908</b>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

## 11. Loans payable (continued)

The subordinated guaranteed bonds are carried at amortised cost. The amortisation schedule is set out below:

	2010 £ 000	2009 £ 000
Nominal value	574,008	590,591
Amortisation in one year	(665)	(710)
Amortisation two to five years	(2,119)	(2,570)
Amortisation over five years	(133)	(403)
<b>As at 31 December</b>	<b>571,091</b>	<b>586,908</b>

The debt repayment schedule for the subordinated guaranteed bonds (by nominal value) is set out below:

## As at 31 December 2010

	Total £ 000	Less than 1 year £ 000	1-2 years £ 000	2-5 years £ 000	More than 5 years £ 000
<b>Subordinated Guaranteed Bonds (nominal value):</b>					
£51m – variable at 7.375%	50,680	-	-	-	50,680
€19m – variable at 6.45%	189,009	-	-	-	189,009
€388m – variable at 4.25%	334,319	-	-	-	334,319
<b>Total</b>	<b>574,008</b>	-	-	-	<b>574,008</b>

## As at 31 December 2009

	Total £ 000	Less than 1 year £ 000	1-2 years £ 000	2-5 years £ 000	More than 5 years £ 000
<b>Subordinated Guaranteed Bonds (nominal value):</b>					
£51m – variable at 7.375%	50,680	-	-	-	50,680
€19m – variable at 6.45%	194,998	-	-	-	194,998
€388m – variable at 4.25%	344,913	-	-	-	344,913
<b>Total</b>	<b>590,591</b>	-	-	-	<b>590,591</b>

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

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

€19m of 6.45% dated Subordinated Guaranteed Bonds maturing on 5 July 2023. Redemption of the bonds is at the option of the Company and is generally not allowable prior to July 2013, after which time if the bond has not been redeemed floating rate interest is payable.

€388m of 4.25% undated Subordinated Guaranteed Bonds. Redemption of the bonds is at the option of the Company and is generally not allowable prior to June 2015, after which time if the bond has not been redeemed floating rate interest is payable.

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

The proceeds of each bond issue were loaned to CMIG on similar interest, repayment and subordination terms as those applicable to the Bonds as detailed in note 6.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

**11. Loans payable (continued)**

On 27 July 2009, the Company redeemed and cancelled subordinated guaranteed bonds as follows:

Tranche	Original issue	Amount redeemed	Outstanding at 31 December 2009	Outstanding at 31 December 2010
7.375%, originally issued Nov 1999 / Dec 2000	£200m	£149m	£51m	£51m
6.45%, originally issued July 2001	€400m	€81m	€19m	€19m
4.25%, originally issued June 2005	€750m	€62m	€88m	€88m

**12. Other financial liabilities**

	2010 £ 000	2009 £ 000
Accrued interest on subordinated guaranteed bonds	13,872	14,316
Amounts due to group undertakings	1,136	242
<b>Total</b>	<b>15,008</b>	<b>14,558</b>

**13. Tax liabilities**

	2010 £ 000	2009 £ 000
Current tax payable	61	892
<b>Total</b>	<b>61</b>	<b>892</b>

**14. Risk management**

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

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

**(a) Governance framework**

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

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

An enterprise-wide risk management framework for the identification, assessment, measurement and management of risk is in place. The framework is in line with Lloyds Banking Group's risk management principles and covers the full spectrum of risks that the Company is exposed to. Under this framework, risks are categorised according to an approved Lloyds Banking Group risk language which has been adopted across the Company. This covers the principal financial risks faced by the Company, including the exposures to market, insurance, credit and financial soundness risk. The performance of the Company, its continuing ability to write business and the strategic management of the business depend on its ability to manage these risks.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

**14. Risk management (continued)**

Lloyds Banking Group retains primary responsibility for the management of investment risks arising within the Company. These are managed in line with the Lloyds Banking Group and LP&I risk policies. Responsibility for the management of all other risks resides with the Board of the Company who have delegated their authority to the LP&I Executive Committee.

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

**(b) Risk appetite**

The Company 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 specified stressed scenarios.

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

**(c) Financial risks**

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

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

The Company manages these risks in a numbers of ways, including risk appetite assessment and monitoring of cashflow requirements. The Company also uses financial instruments as part of its business activities and to reduce its own exposure to market risk and credit risk.

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting policies (note 1) describes how the classes of financial instruments are measured and how income and expenses, including fair value gains and losses, are recognised.

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

	<b>2010</b>	<b>2009</b>
	<b>£ 000</b>	<b>£ 000</b>
<b>Financial assets</b>		
Cash and cash equivalents	62	64
At fair value through income:		
Accrued interest receivable	17,582	17,714
At amortised cost:		
Other receivables	5,964	5,964
Loans receivable	567,362	583,270
	<b>590,970</b>	<b>607,012</b>
<b>Total assets</b>	<b>590,970</b>	<b>607,012</b>
<b>Financial liabilities</b>		
At amortised cost:		
Loans payable	571,091	586,908
Other financial liabilities	15,008	14,558
	<b>586,099</b>	<b>601,466</b>
<b>Other liabilities</b>		
Current tax payable	61	892
<b>Total liabilities</b>	<b>586,160</b>	<b>602,358</b>

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

**14. Risk management (continued)**

A maturity analysis of the financial liabilities set out in the above tables is given in the liquidity risk section of this note.

**(1) Market risk**

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

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

	2010		2009	
	Carrying amount £000	Fair value £000	Carrying amount £000	Fair value £000
Cash and cash equivalents	62	62	64	64
Loans to group undertaking	567,362	489,668	583,270	444,487
Subordinated guaranteed bonds	(571,091)	(489,668)	(586,908)	(444,487)

The carrying amount of Loans to group undertakings above includes £8.5m (2009: £8.2m) due from CMIG in respect of amortised transaction costs. These amounts were previously disclosed within Other receivables.

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

The fair value of Loans to group undertakings and Subordinated guaranteed bonds above are based on the open market value of the Subordinated guaranteed bonds, excluding amortised transaction costs. Transaction costs were previously included in these amounts and the impact of their removal is to increase the fair value of Loans to group undertakings in 2009 by £11.2m and to increase the fair value of Subordinated guaranteed bonds in 2009 by £3.7m.

**(i) Equity and property risk**

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

**(ii) Interest rate risk***Effective interest rates and re-pricing analysis*

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

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

## 14. Risk management (continued)

	Note	Effective Interest rate	2010			Effective Interest rate	2009		
			Total £000	6 months or less £000	More than 5 years £000		Total £000	6 months or less £000	More than 5 years £000
Cash and cash equivalents	8	2.0%	62	62	-	2.0%	64	64	-
Loans to group undertaking:	6								
GBP		7.8%	48,326	-	48,326	7.8%	48,321	-	48,321
Euro		6.6%	186,810	-	186,810	6.6%	192,719	-	192,719
Euro		4.4%	332,226	-	332,226	4.4%	342,230	-	342,230
Subordinated guaranteed bonds:	11								
GBP		7.6%	(50,242)	-	(50,242)	7.6%	(50,208)	-	(50,208)
GBP		7.3%	(136)	-	(136)	7.3%	(136)	-	(136)
Euro		6.5%	(188,724)	-	(188,724)	6.5%	(194,588)	-	(194,588)
Euro		4.4%	(331,989)	-	(331,989)	4.4%	(341,976)	-	(341,976)

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

**(iii) Foreign exchange risk**

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

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

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

The value of the net asset exposure to currencies other than sterling (all Euro) is £804,000 (2009: £816,000).

**(2) Credit risk**

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

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

The Company is primarily exposed to credit risk through the subordinated guaranteed bonds loaned on to CMIG. Accordingly the Company is dependent upon CMIG to meet its commitments in respect of the subordinated guaranteed bonds issued. Management monitor closely the solvency position and the credit risk exposure of CMIG and the Company. They are satisfied that, as a consequence of the risk management procedures in place, as set out in the financial statements of CMIG, this risk is suitably managed.

There were no past due or impaired financial assets at 31 December 2010 (2009: none). No terms in respect of financial assets had been renegotiated at 31 December 2010 or 31 December 2009.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

**14. Risk management (continued)****(3) Financial soundness risk**

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

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

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

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

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

**(ii) Liquidity risk**

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

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

Liquidity risk has been analysed as arising from the settlement of balances owed to other group undertakings of £1,136,000 (2009: £242,000). These amounts are all contractually due within one month from the reporting date.

**(iii) Capital risk**

Capital risk is defined as the risk that:

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

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

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

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

**15. Related party transactions****(a) Ultimate parent and shareholding**

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

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

## 15. Related party transactions (continued)

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

HBOS plc is the parent undertaking of the smallest such group of undertakings. Copies of the Lloyds Banking Group plc financial statements in which the Company is consolidated can be obtained from the Group Secretary's Department, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN.

## (b) Transactions and balances with related parties

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

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

Relationship	Transactions in the Year		Outstanding Balance at 31 December	
	2010 £000	2009 £000	2010 £000	2009 £000
<b>Parent undertakings:</b>				
Tax charge settlement and amounts payable	(892)	(143)	(1,136)	(242)
<b>Other related parties:</b>				
Loans receivable	(16,040)	(703,276)	590,908	606,948

All the transactions summarised above were entered into on an arm's length basis. The amounts outstanding at the end of the year are included in other receivables / payables as appropriate and are repayable on demand unless otherwise specified in the relevant note. The Company paid no dividends to its parent company in the year ended 31 December 2010 (2009: £260m).

The principal activity of the Company is to act as a finance company of Clerical Medical Investment Group Limited, a fellow subsidiary undertaking. In consequence, subordinated debt raised by the Company is loaned to Clerical Medical Investment Group Limited on similar interest, repayment and subordinated terms as those applied to the bonds. For further information see note 11 above.

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

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

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

Key management compensation:	2010 £000	2009 £000
Salaries and other short-term benefits	2	-
Post-employment benefits	-	-
<b>Total</b>	<b>2</b>	<b>-</b>

Certain members of key management in the Company, including the highest paid director, provide services to other companies within the Lloyds Banking Group. In such cases, for the purposes of this note, figures have been included based on an apportionment to the Company of the total compensation earned.

The highest paid Director's emoluments are not required to be disclosed for the year ended 31 December 2010 as they fall below the appropriate threshold.

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

## 15. Related party transactions (continued)

## HM Treasury

In January 2009, HM Treasury became a related party of the Company following its subscription for ordinary shares in Lloyds Banking Group plc, the Company's ultimate parent company, issued under a placing and open offer. As at 31 December 2010, HM Treasury held a 41 percent (2009: 43 percent) interest in Lloyds Banking Group's ordinary share capital and, consequently, HM Treasury remained a related party of the Company throughout 2010.

There were no material transactions between the Company and HM Treasury during the year (2009: none) that were not made in the ordinary course of business or that are unusual in their nature or conditions. In addition, the Company has entered into transactions with HM Treasury on an arm's length basis including, but not exclusively in relation to, the payment of corporation tax, employment tax, and value added tax. Owing to the volume and diversity, such transactions are not disclosed.

## 16. Future accounting developments

The following pronouncements will be relevant to the Company but were not effective at 31 December 2010 and have not been applied in preparing these financial statements. The full impact of these accounting changes is being assessed by the Company. The initial view is that none of these pronouncements are expected to cause any material adjustments to reported numbers in the financial statements.

<b>Pronouncement</b>	<b>Nature of change</b>	<b>IASB effective date</b>
Improvements to IFRSs (issued May 2010)	Sets out minor amendments to IFRS standards as part of the annual improvements process.	Dealt with on a standard by standard basis but not earlier than annual periods beginning on or after 1 July 2010.
IAS 24 <i>Related Party Disclosures</i> <sup>1</sup>	Simplifies the definition of a related party and provides a partial exemption from the disclosure requirements for government related entities	Annual periods beginning on or after 1 January 2011.
Amendment to IAS 32 <i>Financial Instruments: Presentation – 'Classification of Rights Issues'</i>	Requires rights issues denominated in a currency other than the functional currency of the issuer to be classified as equity regardless of the currency in which the exercise price is denominated.	Annual periods beginning on or after 1 February 2010.
IFRS 9 <i>Financial Instruments: Classification and Measurement</i> <sup>1</sup>	Replaces those parts of IAS 39 <i>Financial Instruments: Recognition and Measurement</i> relating to the classification, measurement and derecognition of financial assets and liabilities. It 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 investment categories in the existing IAS 39 will be eliminated. The requirements for financial liabilities and derecognition are broadly unchanged from IAS 39. 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.	Annual periods beginning on or after 1 January 2013.

<sup>1</sup> At the date of this report, these pronouncements are awaiting EU endorsement.

**17. Post balance sheet events**

The Finance Act 2010 (No.2) reduced the rate of corporation tax from 28% to 27% with effect from 1 April 2011. The Chancellor's Budget, announced on 23 March 2011, further reduced the rate of corporation tax to 26% with effect from 1 April 2011. As the Company does not have any deferred tax assets or liabilities, the impact of this reduction in tax rate will be reflected in the financial statements for the year ended 31 December 2011, when the reduced rate will be applied in calculating the tax charge for that year.