

COMPANY REGISTRATION NUMBER: 03730662

**HIGHWAY
INSURANCE COMPANY LIMITED**

**REPORT AND
FINANCIAL STATEMENTS**

FOR THE YEAR ENDED 31 DECEMBER 2015

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HIGHWAY INSURANCE COMPANY LIMITED

DIRECTORS, OFFICERS AND REGISTERED OFFICE

Directors

P M Bunker Resigned 01 January 2016
S V Castle
S C A Fernandes
S R Haynes
M Laidlaw
P W Moore
J B O'Roarke
M J Rogers
P A Horton Resigned 14 September 2015
R Rowney Appointed 26 March 2015
R A Warner
M P Crane Appointed 01 January 2016

Company Secretary

R S Small

Registered office

County Gates
Bournemouth
BH1 2NF

Tel: 01202 292333

Independent Auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London
SE1 2RT

STRATEGIC REPORT

1. Results and dividends

The profit on ordinary activities for the year after taxation is £3,238,000 (2014: £26,926,000) as set out on page 12. The Directors have not proposed or paid any dividends in the current year (2014: £nil).

2. Principal activities

Highway Insurance Company Limited ('Company') principal purpose is to carry on general insurance business through broker distribution channels. The primary sources of premium income are from the sale of Motor insurance products. Motor insurance products include Private Car, Specialist Car, Fleet, Motorcycle and Commercial Vehicles.

3. Business review and developments

(a) Results and performance

The 2015 results for the Company show a profit before taxation of £3,422,000 (2014: £33,727,000), which was underpinned by a strong underwriting profit, but off-set by lower investment returns than previous year. It is the sixth successive year that the Company has reported a profitable result.

The following factors have had a material effect on the result for the year (see also (g): Key Performance Indicators below):

1. Premium written: Market conditions have remained competitive, particularly in Motor. During the first half of the year it was challenging to maintain business volumes in our core Motor markets whilst at the same time implementing the price increases we required in order to achieve our underwriting objectives. This trend began to change in the latter part of 2015, when new business volumes started to increase again, supported by strong renewal rates. The Company has therefore been able to strengthen its competitive position and underwriting margins.
2. Underwriting result: The Company's underwriting profit remained strong and stable during 2015 delivering a combined ratio of 101.7% (2014: 92.6%). Continued support from reserve run-off (excluding margin) is anticipated in future years, however, it is expected that it will be at a lower level than experienced in the recent past (2015: £19.5m, 2014 £34.7m). The high level of reserve run-off seen during 2015 was mostly due to, favourable experience claims development trends seen on low- and mid-sized motor personal injury claims. These trends are in part due to further benefits arising from the implementation of a new claims system in 2013, and further positive impacts arising from the implementation of the Legal Aid, Sentencing and Punishment of Offender Act (LASPO) reforms. This was an exceptional set of circumstances which is not expected to be repeated to the same extent in future
3. Investment returns: 2015 was a challenging year, with the overall returns driven by nervous markets, continued low underlying interest rates and poor performance from equities. The Company's annualised investment return of 1.2% has been impacted by the Company holding more cash and shorter duration bonds during the second half of the year.
4. Expenditure: In response to the competitive market conditions the Company has maintained strong cost disciplines through controlling acquisition costs and operating expenses during the year. Nevertheless, investment in staff, systems, marketing and infrastructure has continued to ensure that the Company is well placed to deliver its profitable growth strategy. It should be noted that although the underlying expense performance has been good the Loss Portfolio Transfer (LPT) reinsurance arrangement implemented at the end of the year has had the effect of increasing the headline expense ratio compared to the prior year.
5. Claims: During 2015 the Company continued to develop its products and enhance its pricing and underwriting processes, which have contributed to improvements in the claims performance.
6. Reinsurance: In the latter part of 2015 the Company entered into a Loss Portfolio Transfer Agreement resulting in reinsurance of 20% of its booked reserves. A whole account 20% quota share arrangement effective 1 January 2016 has also been placed.

STRATEGIC REPORT

(b) Business environment

During the first part of the year the UK Motor insurance market remained very competitive and did not support price increases, underlying claims inflation however continued to build and so margins were squeezed. However toward the latter part of the year the market started to support stronger rates and price increases, building momentum towards more sustainable pricing levels in the future.

The subdued financial markets mean that UK insurers cannot rely on investment returns to deliver as much income as has been generated in the past. Pressure therefore falls on the underwriting activities to deliver higher returns to meet overall financial targets.

Despite these conditions, the Company continued to deliver acceptable returns policy growth in its target market segments.

(c) Strategy

The long term objective of the Group is as follows:

“To maintain its position as a top five general insurer in its target markets and to be active in all major channels: direct, broker, affinity and white-label.

It will be focused on three core products, namely Motor, Home and SME supported by more minor lines such as Road Rescue, Travel and Pet and will utilise a range of strong brands including LV=, Highway, ABC and Britannia Rescue. The Group will operate best-practice processes and technology in order to provide superior customer service through a people-focused and empowered culture. The Group aims to deliver attractive and consistent returns to the members of Liverpool Victoria Friendly Society Limited (‘LVFS’).”

(d) Principal risks and uncertainties

Pricing: Private Motor market rates increased rapidly in the latter half of 2015, following a 40% fall from 2011 to 2014. While pricing in the market finally began to harden the rate increases achieved were eroded by an acceleration in overall market claims inflation. The Directors believe that rates will need to increase further over and above claims inflation through the early part of 2016 in order for the market to achieve acceptable margins.

Economic Environment: The financial market environment during the course of 2015 has been volatile and returns subdued or negative. This situation looks set to remain going into 2016 with significant uncertainties around interest rates, credit spreads, yield levels, and equity markets. As a result, the overall investment return is predicted to remain relatively low (by historical standards) and unpredictable for the next few years.

The Company pays particular attention to credit risk and the increasing trend of claims leakage through fraud. Capital management and cash flow remain material considerations at all times.

Business Change: The Company is still going through a number of material transformation processes (including a full review of some of its core systems) as it continues to prepare for the future. Such change carries with it an element of operational risk; however, The Directors mitigate this risk through a disciplined project management approach.

Distribution/Market developments: The influence of the mobile internet and of price comparison websites (commonly referred to as “aggregators”) continue to transform the UK business environment, although it could be argued that the use of aggregators is now a market norm. Social media continue to be a material feature influencing the way that the Company conducts its business, and are therefore monitored closely by the Company. Insurance specific developments in technology (such as crash avoidance systems, driverless cars etc.) are other potential factors of material market transformation in the future. The Company is ensuring that it is prepared to respond quickly to changing circumstances.

STRATEGIC REPORT

3. Business review and developments (continued)

(d) Principal risks and uncertainties (continued)

Regulatory: A number of legal and regulatory developments affected the UK insurance market during 2015 and will continue into 2016. These include:

1. Solvency II: The Directors monitor all developments and have taken appropriate action to ensure that the Group is well prepared for the Solvency II capital regime which took effect from 1 January 2016. This regime has required significant changes to the solvency and capital management processes of both insurance companies and regulators. The Company will use the Standard Formula to calculate its capital requirements throughout 2016, but intends to apply for Internal Model approval.

2. FCA market intervention: the FCA has made its intention public to intervene more actively in the workings of the market where it feels that the right outcomes are not being achieved for the consumer (e.g. consultation over ancillary fees and price comparison websites). This may result in requirements to change practice in product design, distribution and pricing. While the Group considers that customer value is at the heart of the way it does business, as evidenced by market leading customer satisfaction and recommendation scores, there is a risk that such interventions designed to address general market concerns cause incidental cost and disruption to the Group.

3. Ogden discount rate: There is continued uncertainty in relation to the Ogden discount rate – the rate used by insurance companies to calculate a discounted lump-sum value of the future cost of care, loss of earnings and pensions for large personal injury claims. Although a change is not expected in 2016 a reduction in the rate is a possibility at some point in the future.

Further detail as to how the Group manages its principal types of risk is disclosed in note 5 of the financial statements.

(e) Future outlook

It is projected that the Company will increase its premium income in 2016 and beyond. This growth will come from moderate price and volume increases in the Broker operations. The Company expects to continue to deliver underwriting profits in 2016 while retaining its focus on high levels of customer service and delivering fair customer outcomes.

(f) Significant post Statement of Financial Position events

There have been no events of significance affecting the Company since the Statement of Financial Position date.

STRATEGIC REPORT

3. Business review and developments (continued)

(g) Key performance indicators ('KPIs')

The Board sets KPIs and targets for its main operating businesses, which it monitors on a regular basis throughout the year. These KPIs change from time to time as objectives and priorities change.

The Group uses many detailed KPIs to monitor performance. The main high level ones are as follows:

KPI	2015	2014	Comments
Premiums written	£330m	£305m	As a result of implementing price increases where possible (particularly in Motor) during 2015, the Company reported a year on year increase in the premium written by 8.1%. This was also supported by an underlying policy count increase of 6.0% across a number of lines of business.
Underwriting loss ratio	65.2%	63.8%	Although showing a year on year improvement, the overall reported loss ratio of 65.2% has been favourably impacted by the LPT arrangement secured at the end of the year. The underlying Loss Ratio (before LPT) was 72.8%. This is adverse to the prior year due to the high level of reserves run off in the prior year amounting to £19.5m in the current year and £34.7m in 2014.
Expense ratio *	36.5%	28.8%	The head line Expense Ratio has been adversely impacted by the LPT arrangement secured at the end of 2015. The underlying expense ratio (before LPT) is 28.6%. The year on year expense ratio shows a slight improvement (before LPT) as although expenditure has increased, it did so at a lower level than the increase in earned premiums.
Combined ratio	101.7%	92.6%	An overall combined ratio of 101.7% is adverse to the prior year due to the high level of reserves release in the prior year as noted above.
Investment return	£9.2m	£13.2m	Total investment return includes Investment income and Net fair value gains/losses on financial assets Overall returns reflect low interest rates and poor equity returns. The Company achieved a total investment return of £9.2m which equates to a total annualised return of 1.2% (2014: 2.0%).
Net assets	£276.4m	£273.1m	Net assets are £3.3m higher than in 2014

* Expense ratio excludes investment management costs, but includes ancillary income derived from the sale of principal products.

The Company also uses a range of non-financial KPIs, which are disclosed and managed at ultimate parent company level.

On behalf of the Board of Directors

M J Rogers
Director
11 March 2016

DIRECTORS' REPORT

As permitted by section 414C(11) of the Companies Act 2006, certain information is not included in the Directors' Report because it has instead been shown in the Strategic Report. This information is:

- Results and dividends;
- Principal activities of the Company;
- Business review and future prospects;
- Principal risks and uncertainties.

1. Directors and their interests

The present members of the Board and the members who were in office during the year and up to the date of signing the financial statements are listed on page 3.

2. Parent company

The Company is a wholly owned subsidiary of Highway Insurance Group Limited ('HIG'). The ultimate parent company is LVFS, a friendly society incorporated under the Friendly Societies Act 1992.

3. Employees

The Company did not directly employ any staff during 2014. Instead it utilised the staff and premises of LVFS in carrying out its activities and incurred the cost of staff through management charges.

4. Directors' indemnity statement

The Directors have the benefit of an indemnity which constitutes a "qualifying third party indemnity provision" as defined by Section 234 of the Companies Act 2006. The indemnity was in force throughout the last financial year and is currently in force. LVFS also purchased and maintained throughout the year on behalf of its subsidiaries Directors' and Officers' Liability Insurance in respect of the Company and its Directors. It is available for inspection at the registered office of the Company details of which are provided on page 3.

5. Directors' responsibilities statement

The Directors are responsible for preparing the Strategic Report, Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that year. 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 have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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

The Directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

DIRECTORS' REPORT

6. Independent Auditors and disclosure of information to auditors

Each Director at the date of this report confirms that:

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

Approved by the Board of Directors and signed by order of the Board

R S Small
Company Secretary

11 March 2016

Independent auditors' report to the members of Highway Insurance Company Limited

Report on the financial statements

Our opinion

In our opinion, Highway Insurance Company Limited's financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 31 December 2015 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited

The financial statements, included within the Report and Financial Statements (the "Annual Report"), comprise:

- the statement of financial position as at 31 December 2015;
- the statement of comprehensive income for the year then ended;
- the statement of cash flows for the year then ended;
- the statement of changes in equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the European Union.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinion on other matter prescribed by the Companies Act 2006

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

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Directors' Responsibilities Statement set out on page [7], 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) ("ISAs (UK & 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.

What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). 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.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Andrew G Hill (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
11 March 2016

- (a) The maintenance and integrity of the Liverpool Victoria Friendly Society Limited website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
- (b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

HIGHWAY INSURANCE COMPANY LIMITED

**STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2015**

	Note	2015 £000	2014 £000
Insurance contract premium revenue	6	315,466	307,220
Insurance contract premium ceded to reinsurers	6	(76,203)	(6,638)
Net premium revenue		239,263	300,582
Investment income	7	23,386	25,448
Net fair value losses on financial assets at fair value through income	8	(14,229)	(12,231)
Other income	9	596	724
Total income		249,016	314,523
Insurance claims and loss adjustment expenses	10	(229,302)	(194,624)
Insurance claims and loss adjustment expenses recoverable from reinsurers	10	73,402	2,813
Net insurance claims		(155,900)	(191,811)
Finance costs	11	(319)	(389)
Other operating and administrative expenses	12	(89,375)	(88,596)
Total claims and expenses		(245,594)	(280,796)
Profit before tax		3,422	33,727
Income tax expense	15	(184)	(6,801)
Profit for the year attributable to the owners of the parent		3,238	26,926
Total comprehensive income for the year		3,238	26,926

All balances relate to continuing business.

The notes on pages 16 to 54 are an integral part of the financial statements.

HIGHWAY INSURANCE COMPANY LIMITED**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2015**

	Note	Attributable to equity holder of the Company			
		Share capital	Retained earnings	Capital reserve	Total Equity
		£000	£000	£000	£000
Balance at 1 January 2015		75,000	48,132	150,000	273,132
Profit for the year	33	-	3,238	-	3,238
Balance at 31 December 2015		75,000	51,370	150,000	276,370

	Note	Attributable to equity holder of the Company			
		Share capital	Retained earnings	Capital reserve	Total Equity
		£000	£000	£000	£000
Balance at 1 January 2014		75,000	21,206	150,000	246,206
Profit for the year	33	-	26,926	-	26,926
Balance at 31 December 2014		75,000	48,132	150,000	273,132

The notes on pages 16 to 54 are an integral part of the financial statements.

HIGHWAY INSURANCE COMPANY LIMITED

**STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2015**

	Note	2015 £000	2014 £000
Assets			
Deferred tax asset	18	167	215
Current tax asset	17	1,864	-
Prepayments and accrued income	19	6,388	9,771
Deferred acquisition costs	16	26,434	24,567
Financial assets			
- Fair value through income	20	496,922	606,424
- Derivative financial instruments	21	610	225
Loans and other receivables	22	3,153	11,910
Reinsurance assets	23	160,209	88,773
Insurance receivables	24	35,778	29,481
Cash and cash equivalents	25	231,765	121,114
Total assets		963,290	892,480
Liabilities			
Insurance Contract Liabilities	26	592,698	576,929
Provisions	27	11	11
Current tax liability	17	-	3,100
Financial liabilities			
- Derivative financial instruments	21	23	11,863
- Other	28	9,524	9,563
Insurance payables	29	68,295	847
Trade and other payables	30	16,369	17,035
Total liabilities		686,920	619,348
Equity			
Share capital	31	75,000	75,000
Capital reserve	32	150,000	150,000
Retained earnings	33	51,370	48,132
Total equity		276,370	273,132
Total liabilities and equity		963,290	892,480

The notes on pages 16 to 54 are an integral part of the financial statements.

These financial statements were approved by the Board of Directors on 11 March 2016.

Signed on behalf of the Board of Directors

P W Moore
Director
11 March 2016

HIGHWAY INSURANCE COMPANY LIMITED**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2015**

	Note	2015 £000	2014 £000
Cash and cash equivalents at 1 January	25	117,920	142,407
Cash flows arising from:			
Operating activities			
Cash generated from/(used in) operating activities	34	7,514	(49,710)
Net decrease in investments at fair value through income		83,047	6,504
Dividend income received	7	2,557	2,069
Interest income received		24,156	22,535
Finance cost paid	11	(319)	(389)
Income tax paid	17	(5,100)	(5,496)
Net cash flows generated from/(used in) operating activities		111,855	(24,487)
Net increase / (decrease) in cash and cash equivalents		111,855	(24,487)
Cash and cash equivalents at 31 December	25	229,775	117,920

The notes on pages 16 to 54 are an integral part of the financial statements.

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. General information

The Company is limited by shares and incorporated in the United Kingdom. The Company underwrites general insurance risks, including motor risks. All contracts of insurance are written in the United Kingdom and Republic of Ireland.

2. Basis of presentation

These financial statements have been prepared in accordance with IFRSs and interpretations issued by the IFRS Interpretations Committee (IFRSIC) as published by the International Accounting Standards Board and adopted by the European Union (EU). In addition the financial statements comply with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

These consolidated financial statements have been prepared under the historic cost convention, as modified by the revaluation of financial assets and liabilities at fair value through income. The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated. Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). Unless otherwise noted, the consolidated financial statements are presented in thousands of pounds sterling, which is the Company's presentation currency.

Insurance contracts are accounted for in accordance with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005, and amended in 2006. Whilst this SORP is no longer in force, the Company continues to apply it, as it was existing accounting practices for insurance contracts when the Company first time adopted IFRS.

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and liabilities at fair value through income.

The preparation of the financial statements in conformity with IFRSs requires the use of estimates. It also requires management to exercise judgement in the process of applying the accounting policies. The key areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the accounts are disclosed in the Significant Accounting Judgements note 4.

After making enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. The Company therefore continues to adopt the going concern basis in preparing its financial statements.

Restatement

The following reclassifications were made by the Group during the year:

- 2014 Prepayments were restated to adjust the split between accrued interest and other prepayments and accrued income.

The principal accounting policies adopted are listed below. These policies have been consistently applied to all years presented, unless otherwise stated.

3. Accounting policies

Premiums

General insurance premiums written reflect business coming into force during the year. Earned premium is written premium adjusted for unearned premium. Unearned premium is that proportion of a premium written in a year that relates to periods of risk after the statement of financial position date. Unearned premiums are calculated on a time apportionment basis. The proportion attributable to subsequent periods is deferred as a provision for unearned premiums.

Reinsurance contracts

The Company cedes some of the insurance risk in its general insurance business to reinsurers. Reinsurance assets represent balances due from reinsurance companies. Recoverable amounts are estimated in a manner consistent with the outstanding claims provision and in accordance with the reinsurance contracts. Reinsurance premiums are recognised in the same period as the underlying contract to which they relate.

Investment income

Investment income includes dividends, interest from investments at fair value and interest on loans and receivables. Dividends are included on an ex-dividend basis. Investment expenses are accounted for as incurred.

Realised gains or losses

Realised gains and losses on investments are calculated as the difference between net sales proceeds and purchase price.

Unrealised gains and losses

Unrealised gains and losses on investments represent the difference between the valuation of fair value assets at the Statement of Financial Position date and their valuation at the last Statement of Financial Position date or, where purchased during the year, the purchase price. An adjustment is made to unrealised gains and losses for the prior year's unrealised element included in the current year's realised gains and losses.

3. Accounting policies (continued)

Income taxes

The income tax expense reflects the movement in current and deferred income tax in respect of income, gains, losses and expenses.

- Current income tax

Current income tax liabilities and assets are measured at the amount expected to be paid to or recovered from the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the statement of financial position date.

- Deferred tax

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the Statement of Financial Position date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

Foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated to sterling at rates of exchange ruling at the statement of financial position date. Purchases and sales of investments denominated in foreign currencies are translated at the rates prevailing at the dates of the respective transactions. Exchange gains and losses are dealt with in that part of the Statement of Comprehensive Income in which the underlying transaction is reported.

Deferred acquisition costs

The costs of acquiring new business, which are incurred during the financial year, but where the benefit of such costs will be obtained in subsequent accounting periods, are deferred and recognised as an asset to the extent that they are recoverable out of margins in future matching revenues. All other costs are expensed when they are incurred.

In respect of insurance contracts, acquisition costs comprise all allowable costs incurred in writing new contracts. Deferred acquisition costs are amortised over the life of the policy in line with the recognition of premiums.

All deferred acquisition costs are tested for recoverability at each reporting date. The carrying values are adjusted to recoverable amounts and any resulting impairment losses are charged to the Statement of Comprehensive Income.

Liability adequacy test

At each statement of financial position date liability adequacy tests are performed to ensure the adequacy of insurance contract liabilities, net of related deferred acquisition costs. In performing these tests current best estimates of future contractual cash flows and claims handling and administration expenses as well as investment income from the assets backing such liabilities are used. Any deficiency is immediately charged to the Statement of Comprehensive Income initially by writing off deferred acquisition costs and by subsequently establishing an unexpired risk provision. Any deferred acquisition cost written off as a result of this test cannot subsequently be reinstated.

3. Accounting policies (continued)

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the net identifiable assets of the acquired book of business at the acquisition date and is included in intangible assets. Goodwill is reviewed for impairment at the end of the first full year of acquisition. Thereafter, it is tested at each Statement of Financial Position date for impairment against the recoverable amount (being the higher of value in use or fair value less cost) of the relevant cash generating unit and carried in the Statement of Financial Position at cost less accumulated impairment losses.

Other intangibles

Where an acquisition takes place that gives access to existing customers or distribution channels, then the present value of these is recognised as an intangible asset. The carrying value of the asset is amortised over its expected economic life, and is assessed as and when impairment may be indicated.

The expected economic life of other intangibles is determined by reference to acquired business, considering factors such as the remaining terms of agreements, the normal lives of related products and the competitive position, and lies within the range of 10 to 20 years.

Investments in Group undertakings

The subsidiaries are held in the Company's Statement of Financial Position at cost less any provision for impairment. An assessment of the realisable value is made at the year end and, if the Directors assess that there has been a permanent fall in that value below the carrying value, a provision is made to bring the carrying value down to the assessed realisable value.

Derivative financial instruments

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. There are no designated hedging relationships that qualify for hedge accounting; all are classified as held for trading. Derivatives are settled on a gross basis.

Changes in the fair value of derivative instruments are recognised immediately in gains or losses on investments in the Statement of Comprehensive Income for the period. Realised gains or losses are similarly taken to the Statement of Comprehensive Income on occurrence.

Financial assets at fair value through income

All investments of the Company classified as fair value are designated as fair value through income at inception. Such assets are valued at market prices, or prices consistent with market ratings should no price be available. Day one gains or losses are recognised only where valuations use data from observable markets. Any unrealised or realised gains or losses are taken to the Statement of Comprehensive Income, as fair value gains or losses, or realised gains or losses respectively, as they occur.

Collective investment schemes

Collective investment schemes are included within financial assets at fair value through income and their accounting treatment is consistent with that of financial assets at fair value through income.

3. Accounting policies (continued)

Collateral

Collateral is received or pledged against derivative contracts in the form of cash collateral and non-cash collateral.

a) Cash collateral

Cash collateral received, which is not legally segregated from the Company, is recognised as an asset with a corresponding liability for its repayment in the Statement of Financial Position.

Cash collateral pledged, which is legally segregated from the Company, is derecognised from Cash and cash equivalents and a corresponding asset for its return is recognised in the Statement of Financial Position.

b) Non-cash collateral

Non-cash collateral received against derivative contracts where the counterparty is not in default, that is neither sold nor repledged, is not recognised in the Statement of Financial Position. Non-cash collateral pledged against derivative contracts where the Company is not in default is not derecognised from the Statement of Financial Position and remains within the appropriate asset classification.

Insurance receivables and payables

Insurance receivables and payables are recognised when due and include amounts due from or to policyholders, agents, brokers and reinsurers. Amounts due from policyholders and brokers include outstanding premiums where the policyholders have elected to pay in instalments. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

Insurance receivables and payables are initially recognised at fair value and subsequently held at amortised cost. Where there is objective evidence that the carrying value of insurance receivables is impaired then the impairment loss will be recognised in the Statement of Comprehensive Income.

Loans and other receivables

Loans and other receivables are recognised when due and comprise amounts due from Group undertakings and other receivables. Loans and other receivables are initially recognised at fair value and then subsequently held at amortised cost.

The Company assesses at each Statement of Financial Position date whether a loan or receivable, or a group of loans or receivables, is impaired. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the Statement of Comprehensive Income.

Subordinated liabilities

Subordinated liabilities are initially measured at the fair value of the proceeds less attributable transaction costs. Subsequent to initial recognition they are measured at amortised cost. The transaction costs are amortised over the period to the earliest possible redemption date on an effective interest rate basis. The amortisation charge is included in the Statement of Comprehensive Income within finance costs. An equivalent amount is added to the carrying value of the liability such that at the redemption date the value of the liability equals the redemption value.

Amounts recoverable from or due to reinsurers

Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

3. Accounting policies (continued)

Reinsurance assets

Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on the insurance contracts issued by the Group are classified as reinsurance contracts. A contract is only accounted for as a reinsurance contract where there is significant insurance risk transfer between the insured and the insurer. Reinsurance assets include balances due from reinsurance companies for ceded insurance liabilities. Amounts recoverable from reinsurers are estimated in a consistent manner with the outstanding claims provisions or settled claims associated with the reinsured policies and in accordance with the relevant reinsurance contract.

An impairment review is performed at the Statement of Financial Position date. Impairment occurs when there is evidence that the Company will not recover outstanding amounts under the contract, such losses being recorded immediately in the Statement of Comprehensive Income.

Impairment of assets

The Company assesses at each Statement of Financial Position whether there is objective evidence that a financial asset or group of financial assets not held at fair value through income is impaired. Impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of financial 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, such as a default or delinquency in payments;
- (iii) it becoming probable that the issuer or debtor will enter bankruptcy or other financial reorganisation;
- (iv) the disappearance of an active market for that financial asset; or
- (v) observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the Group, including:
 - adverse changes in the payment status of issuers or debtors in the Group; or
 - national or local economic conditions that correlate with defaults on the assets in the Group.

The Company first assesses whether objective evidence of impairment exists for individually significant financial assets and if no such individual impairment exists it collectively considers impairments of groups of assets with similar credit risks.

If there is objective evidence that an impairment loss has been incurred, the carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the statement of comprehensive income for the period.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the statement of comprehensive income for the period.

3. Accounting policies (continued)

Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand, and short term deposits with an original maturity of three months or less.

For the purpose of the Statement of Cash Flows, Cash and cash equivalents are as defined above but are shown net of outstanding bank overdrafts.

Trade and other payables

Trade and other payables are recognised as they fall due. They are initially recognised at fair value and subsequently held at amortised cost.

Trade and other payables include accruals for levies which are recognised when the obligating event of sales of insurance premiums occurs. Accrual is made in accordance with the requirements of the relevant levy legislation.

Claims and insurance contract liabilities

Claims incurred comprise claims and related internal and external claims handling costs paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported and related claims handling costs, together with any other adjustments to claims from previous years. Where applicable, deductions are made for recoveries from other parties.

Provision is made for the estimated cost of claims incurred but not settled, including the cost of claims incurred but not reported. The estimated cost of claims includes expenses to be incurred in settling claims and a deduction for the expected value of recoveries. However, given the inevitable uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established. Provisions are adjusted at the Statement of Financial Position date to represent a best estimate of the expected outcome.

Standard actuarial claims projection techniques are used to estimate outstanding claims. Such methods extrapolate the development of paid and incurred claims, recoveries from third parties, average cost per claim and ultimate claim numbers for each accident year, based upon the observed development of earlier years and expected loss ratios. The main assumption underlying these techniques is that past claims development experience can be used to project ultimate claims costs. In the case of PPOs, the annuity type structure of the claim payments mean that these have to be projected over a longer-term period and reserved for on a discounted basis accordingly. Allowance for one off occurrences or changes in legislation, policy conditions or portfolio mix, is also made in arriving at the estimated ultimate cost of claims, in order that it represents the most likely outcome, taking account of all the uncertainties involved. To the extent that the ultimate cost is different from the estimate, where experience is better or worse than that assumed, the surplus or deficit will be credited or charged to the Statement of Comprehensive Income in future years.

Provisions are calculated allowing for reinsurance recoveries and a separate asset is recorded for the reinsurers' share of the provision.

Share capital

Shares are classified as equity when there is no obligation to transfer cash or other assets.

3. Accounting policies (continued)

Changes in Accounting Policies

(i) New and amended standards adopted by the Company

There were no new and amended accounting standards adopted by the Company for the first time for the financial year beginning on or after 1 January 2015.

(ii) New standards and interpretations not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2016; these have not therefore been applied in preparing these financial statements. None of these are expected to have a significant effect on the financial statements of the Company, except for the following:

Amendment to IAS 1 'Presentation of financial statements' seeks to clarify the disclosure requirements including considering the impact of materiality on the level of disaggregation and extent of disclosures presented; disclosure of additional sub totals and reconciliation to those required by IAS 1; and also additional flexibility regarding the order of notes to the financial statements. This amendment is effective from 1 January 2016 and will be adopted by the Company. The Company has reviewed the disclosures included in the financial statements against this amendment. As this amendment merely clarifies the existing requirements of IAS 1 the Company does not consider the impact of the amendment to be significant.

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through OCI and fair value through P&L. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in OCI not recycling. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. The standard is effective for accounting periods beginning on or after 1 January 2018. The Company is currently assessing the impact of this new standard.

There are no other IFRSs or IFRIC interpretations that are not yet effective that are expected to have a material impact on the Company.

4. Significant accounting judgements, estimates and assumptions

In applying the Company's accounting policies, Management has made the following judgements, estimations and assumptions which have the most significant effect on the financial statements.

Fair value of financial assets

In the absence of an active market estimation of fair value is achieved by using valuation techniques such as recent arm's length transactions, discounted cash flow analysis, the application of suitable indices to earlier valuations and option pricing models. This valuation will also take into account the marketability of the assets being valued.

Valuation of general insurance contract liabilities

The estimation of the ultimate liability arising from claims made under insurance contracts is the Company's most critical accounting estimate. For general insurance contracts estimates are made for the expected ultimate cost of claims as at the Statement of Financial Position date and the cost of claims incurred but not yet reported to the Company. It can take a significant period of time before the ultimate cost of claims can be established with certainty, and the final outcome may be better or worse than that provided. While Management believes that the insurance contract liabilities carried at year end are adequate, the application of statistical techniques requires significant judgment.

The estimation of these claims is based on historical experience projected forward. Where possible, the Company adopts multiple techniques to provide a best estimate of the required level of provisions. This assists in developing greater understanding of the trends inherent in the data being projected. The Company's estimates of losses and loss expenses are reached after a review of several commonly accepted actuarial projection methodologies, as well as more bespoke methods and a number of different bases to determine these provisions. These include methods based upon the following:

- The development of previously paid claims, where payments to date are extrapolated for each prior year;
- estimates based upon a projection of claims numbers and average cost;
- incurred claims development, where incurred claims to date for each year are extrapolated based upon observed development of earlier years; and
- expected loss ratios.

There are several sources of uncertainty that need to be considered in the estimate of the liability that the Company will ultimately pay for such claims. In particular, motor insurance policies are exposed to claims for bodily injury.

Estimation of the ultimate cost of large bodily injury claims is a complex process and cannot be done using conventional actuarial techniques given they typically exhibit low frequency and high severity. Significant factors that affect the bodily injuries estimation process are legislation (e.g. the Ogden discount rate used to value lump sum settlements) and the presence of Claims Management Companies operating within the General Insurance market. Due to this uncertainty it is not possible to determine the future development of bodily injury claims with the same degree of reliability as with other types of claims. Over the last decade, there has been an increasing prevalence of Periodic Payment Order ('PPO') settlements. These settlements have an annuity-type structure, i.e. they are typically paid annually over the claimant's life. Courts may decide that a claim should be settled on a PPO basis, but in some cases the claimant will request such a settlement. Market data analysis suggests that circa 30% of claims costing in excess of £1m are now settling on a PPO basis and therefore these claims are representing a greater proportion of the liabilities year-on-year. As it is unclear whether a large claim will settle on a PPO basis or on the traditional lump sum basis, there is further uncertainty in the bodily injury projections. A further complexity of PPO claims is that due to the annuity-type structure of the claim payments these have to be projected over a longer-term period and reserved for on a discounted basis accordingly. Therefore, the estimation of ultimate claims cost now involves projecting mortality rates, discount rates and benefit indexation rates, which is unlike all other general insurance liabilities

4. Significant accounting judgements, estimates and assumptions (continued)

Large claims impacting each relevant business class are generally assessed separately, being measured either at the face value of the loss adjusters' estimates or projected separately in order to allow for the future development of large claims.

Provisions are initially calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts that will be recoverable from reinsurers based upon the gross provisions and having due regard to collectability.

Claims provisions are subject to close scrutiny, both within the Company and across the wider LVFS Group. The Group has an Audit Committee the membership of which is drawn wholly from non-executive members of the board of LVFS, with the purpose of reviewing reserves, challenging the assumptions made by Management and recommending the level of reserves held. This committee operates as a forum for the discussion and challenge of the actuarial best estimate and booked claims provisions. External actuaries are also engaged on an annual basis to calculate an independent best estimate of the ultimate cost of claims against which the Company's best estimate is assessed.

Classification of the Company's contracts with reinsurers as reinsurance contracts

A contract is required to transfer significant insurance risk in order to be classified as a reinsurance contract. Management reviews all terms and conditions of each such contract, and if necessary obtains the opinion of an independent expert at the negotiation stage in order to be able to make this judgement.

Other

The judgments, estimations and assumptions around financial assets and claims judgments are discussed in Note 5.

5. Capital management and risk management and control

The Company maintains a capital structure which consists of a combination of share capital, retained earnings and a capital reserve, consistent with the Company's risk profile and the regulatory and market requirements of its business.

The Company retains capital to meet four key objectives:

- (i) To ensure the Company's strategy can be implemented and is financially sustainable;
- (ii) To ensure the Company's financial strength and to support the risks it takes on as part of its business;
- (iii) To give confidence to policyholders and other stakeholders who have relationships with the Company; and
- (iv) To comply with capital requirements imposed by its UK regulator, the Prudential Regulatory Authority ('PRA').

At least annually these objectives are reviewed and benchmarks are set by which to judge the adequacy of the Company's capital. The capital position is monitored against those benchmarks to ensure that sufficient capital is available to the Company. In the event that sufficient capital is not available plans would be developed either to raise additional capital through, for example, subordinated loans, or to reduce the amount of risk accepted thereby reducing the capital requirement through, for example, reinsurance or a change in investment strategy. If it becomes apparent that excess capital is available to the Company above its potential needs such excess would normally be returned to shareholders.

In the latter part of 2015 the Company entered into a Loss Portfolio Transfer Agreement resulting in reinsurance of 20% of its booked reserves. The Company also entered into a 20% Quota Share arrangement for 2016-2018 (each year treated separately). The primary driver of both transactions was efficient capital management.

2015 is the final year of the PRA's ICAS solvency regime. Under this regime, the PRA imposes two separate capital requirements on the Company: the Minimum Capital Requirement ('MCR') as defined in the PRA regulations and reported publicly in the annual PRA returns prepared by the Company's regulated subsidiaries; and Individual Capital Guidance ('ICG'), which is entity specific and is derived using a more risk-related approach as set out in the PRA regulations. The ICG is calculated and updated by the PRA following its reviews on a regular basis of the Company's own Individual Capital Assessment ('ICA').

2016 marks the beginning of the Solvency II regime, an EU imposed legislation, which for UK firms replaces the ICAS regime. There are again two separate capital requirements; the Minimum Capital Requirement ('MCR') and the Solvency Capital Requirement ('SCR'). The SCR can be calculated using a Standard Formula, as specified in the regulatory text, or an Internal Model, which is unique to each firm and must be approved by the firm's local regulator. The Company will use the Standard Formula to calculate its capital requirements throughout 2016, but intends to apply for Internal Model approval during 2016.

As at 31 December 2015, the Company disclosed regulatory capital of £284,967,000 (2014: £281,963,000) being the solo adjusted pillar 1 capital as stated in its 2015 PRA return.

5. Capital management and risk management and control (continued)

Risk management and control

The principal types of risk, which are detailed below, have been identified and risk appetite for each of these has been set by reference to the PRA's ICA capital requirements.

The Company recognises the critical importance of having efficient and effective risk management systems in place and these take the form of:

- Board and Executive committees with clear terms of reference.
- A clear organisation structure with documented apportionment of responsibilities.
- A uniform methodology of risk assessment, which is embedded within all companies in the LVFS Group so that they operate within agreed tolerances and with appropriate controls in place.
- A statement of Risk Strategy and Appetite, which is reviewed annually and adopted by the Directors.
- Regular reviews of risks by senior managers, where frequency of review is determined by the potential impact of the risk and its likelihood.

Insurance risk

The Company's insurance activities are primarily concerned with the pricing, accepting and management of risks from its policyholders. In accepting risks the Company commits to paying claims and therefore these risks must be understood. The Company manages these risks through its underwriting strategy, reinsurance arrangements and proactive claims handling.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Company faces under its insurance contracts is the risk that actual claims exceed the carrying value of the Company's claims reserves. The risk arises from the inherent uncertainties as to the occurrence, amount and timing of insurance claims. For general insurance contracts this is primarily represented by exposure to risks which may lead to significant claims in terms of frequency or value. These would primarily include large personal injury claims, but would also include exposure to significant weather events impacting motor business. There is also a risk that the prices charged for unexpired risks to which the Company is contractually committed may prove to be insufficient to absorb the cost of the claims which they will generate and any related DAC. Procedures are in place to measure, monitor and control exposure to all these risks.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected by a change in any subset of the portfolio. The Company has developed its insurance underwriting strategy to diversify the type of insurance risks accepted and within each of these categories to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

Motor business is exposed to the risk of large bodily injury claims, where the claim amounts can be significant due to the cost of care required for the claimant. The Company has entered into excess of loss reinsurance contracts which reduce its exposure to large claims. The Company's retention is £5.0m per claim (2014: £5.0m per claim; £5.0m-£10.0m layer 68% placed).

In addition to the reinsurance contract described above, the Company has also entered into a Loss Portfolio Transfer Agreement resulting in reinsurance of 20% of its booked reserves. The Company also entered into a 20% Quota Share arrangement for 2016-2018 (each year treated separately). Whilst the primary driver of these transactions was efficient capital management, the contract also has the effect of reducing the LVFS group exposure to general insurance concentration risk.

The Company has historic Quota Share and Excess of Loss reinsurance contracts which reduce the Company's exposure to large claims.

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

5. Capital management and risk management and control (continued)

The table below sets out the concentration of general insurance contract liabilities by type of contract:

	2015			2014		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Motor	332,712	(135,393)	197,319	340,757	(79,237)	261,520
Commercial	94,846	(24,677)	70,169	85,419	(9,317)	76,102
	427,558	(160,070)	267,488	426,176	(88,554)	337,622

The claims provision is the estimated cost of outstanding claims from expired risks. The provision is calculated largely from using the Company's historic claims development data. How much the past claim development will reflect future claims development will be impacted by the following factors:

- Changes in actuarial processes and methodology.
- Changes in risk profile.
- Changes in underwriting, rating and policy conditions.
- Changes in legislation and regulation (e.g. PPOs, Ministry of Justice reforms, changes to the Ogden discount rate, etc.).
- Changes in other external factors (e.g. "claims farming"/accident management firms).

It is therefore important that the impact of these items on claims development is understood. Whilst every effort has been made to ensure the claims provision appropriately allows for such changes, there remains uncertainty in the eventual reserve outcome as a result. This uncertainty can change from year to year depending on the timing and magnitude of these items.

The Company has identified the major uncertainties surrounding the future development of claims. Where appropriate these have been allowed for explicitly. An additional provision is also held within the claims provision to cover the uncertainty around further fluctuations in claim development with a given degree of confidence.

5. Capital management and risk management and control (continued)

The claims provision includes a specific allowance for claims identified as having the potential to settle on a PPO basis. This allowance is based on the mean cost of claims derived from a range of scenarios based on the PPO settlement rate for these claims. If all of these claims settled as PPOs, the reserves would deteriorate by an estimated £5.0m from the position shown above.

Uncertainty in claims estimation is larger for claims such as PPOs for which annually indexed payments are made typically over the lifetime of the injured party. Claims reserves for PPOs are held on a discounted basis and are sensitive to a change in the discount rate. The table below provides a sensitivity analysis of the potential impact of a change in a single factor with all other assumptions left unchanged. Other potential risks beyond the ones described in the table could have an additional financial impact on the Company.

	Increase / (Decrease) in income statement		Increase / (Decrease) in total equity at 31 st December	
	2015	2014	2015	2014
	£m	£m	£m	£m
Impact of a 1% increase in the discount rate used to value PPOs	8.0	5.2	8.0	5.2
Impact of a 1% reduction in the discount rate used to value PPOs	(13.2)	(8.5)	(13.2)	(8.5)

The claims provision is also sensitive to the number and cost of large motor claims (defined as greater than £1.0m), which have been incurred but not reported and reserved. We would typically expect a number of large claims from expired risks to be identified in the future, either from being newly reported or from existing claims increasing in magnitude above the £1.0m threshold. The claims provision allows for £11.0m of late reported/reserved large claims above £1.0m gross of reinsurance. Therefore, if for example three new claims were reported, each being £5.0m above the £1.0m threshold, this would lead to a £4.0m deterioration in the reserves, whereas one new claim of this type would lead to a £6.0m improvement.

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

5. Capital management and risk management and control (continued)

The tables below reflect the cumulative incurred claims including both claims notified and incurred but not reported ('IBNR') for each successive accident year at each Statement of Financial Position date, together with the cumulative payments to date. The Company aims to maintain appropriate reserves in order to protect against adverse future claims experience and developments.

Analysis of claims development – gross of reinsurance

Accident year	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	Total £m
Initial estimate of gross provision	184.5	186.7	208.4	231.0	247.8	286.4	282.4	241.0	221.3	247.6	
One year later	180.0	196.8	243.6	226.4	274.7	279.6	272.9	222.1	204.9		
Two years later	179.7	198.5	220.0	232.4	283.0	274.6	266.6	222.7			
Three years later	179.5	200.7	212.0	234.5	280.6	272.1	261.2				
Four years later	173.9	202.8	213.6	245.5	275.6	271.2					
Five years later	174.4	207.7	209.4	244.8	282.1						
Six years later	174.5	208.7	205.2	244.3							
Seven years later	175.3	209.3	203.8								
Eight years later	176.9	211.2									
Nine years later	176.3										
Current estimate of cumulative claims	176.3	211.2	203.8	244.3	282.1	271.2	261.2	222.7	204.9	247.6	2,325.3
Cumulative payments to date	(172.0)	(186.4)	(203.2)	(241.5)	(250.2)	(262.6)	(212.5)	(162.2)	(141.0)	(93.4)	(1,925.0)
Liability recognised for 2006 to 2015 accident years	4.3	24.8	0.6	2.8	31.9	8.6	48.7	60.5	63.9	154.2	400.3
Liability recognised in respect of prior accident years											23.2
Claims handling provision											4.1
Provision as at 31 December 2015											427.6

Analysis of claims development – net of reinsurance

Accident year	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	Total £m
Initial estimate of net provision	147.0	136.7	179.3	211.4	243.8	283.4	268.1	232.6	219.0	208.9	
One year later	129.3	151.5	191.2	221.1	260.1	277.4	259.7	211.1	188.7		
Two years later	143.0	151.5	187.5	219.0	269.6	272.7	255.2	202.0			
Three years later	141.6	158.1	181.8	220.0	263.7	270.8	244.7				
Four years later	140.4	147.5	183.8	229.6	259.4	269.4					
Five years later	138.9	147.7	178.4	224.9	262.8						
Six years later	139.0	146.6	178.0	223.6							
Seven years later	139.8	146.1	177.3								
Eight years later	138.6	146.0									
Nine years later	137.5										
Current estimate of cumulative claims	137.5	146.0	177.3	223.6	262.8	269.4	244.7	202.0	188.7	208.9	2,060.9
Cumulative payments to date	(136.1)	(145.5)	(176.9)	(222.9)	(250.2)	(262.6)	(212.4)	(160.8)	(140.4)	(93.4)	(1,801.2)
Liability recognised for 2006 to 2015 accident years	1.4	0.5	0.4	0.7	12.6	6.8	32.3	41.2	48.3	115.5	259.7
Liability recognised in respect of prior accident years											3.7
Claims handling provision											4.1
Provision as at 31 December 2015											267.5

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

5. Capital management and risk management and control (continued)

Market risk

Market risk is the risk of adverse or favourable impacts due to fluctuations in bond yields, equity prices, interest rates, or exchange rates. The Company has defined policies and procedures in place to control the major components of market risk. Exposures to individual companies and to equity shares in aggregate are monitored by Investment and Asset & Liability Committees in order to ensure compliance with the relevant regulatory limits for solvency purposes and with guidelines set for each internal fund. Securities held are primarily listed and traded on recognised stock exchanges, predominantly in the UK.

Limits on the Company's exposure to equities are defined both in aggregate terms and by geography, industry and counterparty. The level of investment holdings is reviewed quarterly by the Board's Investment Committee. Tactical asset allocation meetings are held monthly or more regularly if required, and strategic asset allocation meetings quarterly, to discuss investment return and concentration and to agree any changes required.

Equity risk

The Company's objective is to earn competitive relative returns by investing in a diverse portfolio of high quality securities. Holdings are diversified across industries and concentrations in any one company or industry are limited by parameters established by the Investment Committee.

The Company also makes use of derivatives to manage this risk.

Currency risk

The Company operates predominately within the UK, it has some exposure to foreign currencies through its investment portfolio and financial liabilities. Its main currency exposures are the Euro and the US dollar.

The Company's general policy is to run no foreign exchange risk. However the Company's Investment Managers may from time to time run a small exposure having agreed any such exposure with the Investment Committee. An open Euro position is maintained to hedge the subordinated note (see Note 28) and other minor insurance liabilities. The Company purchases forward foreign exchange contracts to hedge the exposure to foreign exchange movements.

	2015 £000	2015 £000	2014 £000	2014 £000
Interest rate risk				
+ 50 basis points shift in yield curve	2,713	2,170	(87)	(68)
- 50 basis points shift in yield curve	(2,753)	(2,202)	88	69
Credit spread risk				
100 basis points widening in all credit spreads	(5,234)	(4,187)	(10,960)	(8,604)
100 basis points tightening in all credit spreads	5,084	4,068	11,456	8,993
Equity risk (including derivatives)				
20% increase in equity markets	5,586	4,469	1,294	1,016
20% decrease in equity markets	(6,983)	(5,586)	(3,053)	(2,397)

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

5. Capital management and risk management and control (continued)

The Company's exposure to foreign exchange risk is summarised below:

	USD	Euro	Total
	£000	£000	£000
As at 31 December 2015			
Financial assets at fair value through income			
Shares, other variable yield securities and units in unit trusts	185	-	185
Shares, other variable yield securities and units in unit trusts - impairment	185	-	185
Debt and other fixed income securities	-	528	528
Derivative financial instruments	(862)	-	(862)
Reinsurers' share of insurance contract liabilities	-	8,994	8,994
Cash and cash equivalents	488	11,795	12,283
Insurance contracts	-	(12,198)	(12,198)
Other financial liabilities	-	(8,844)	(8,844)
Total exposure	(4)	275	271

	USD	Euro	Total
	£000	£000	£000
As at 31 December 2014			
Financial assets at fair value through income			
Shares, other variable yield securities and units in unit trusts	420	-	420
Shares, other variable yield securities and units in unit trusts - impairment	420	-	420
Debt and other fixed income securities	-	975	975
Derivative financial instruments	(1,150)	-	(1,150)
Reinsurers' share of insurance contract liabilities	-	10,799	10,799
Cash and cash equivalents	303	16,323	16,626
Insurance contracts	-	(18,381)	(18,381)
Other financial liabilities	-	(9,313)	(9,313)
Total exposure	(7)	403	396

The sensitivity of investment assets to a 10% increase/decrease in Euro and US Dollar exchange rates net of derivatives is £400 (2014: £700) and £27,500 (2014: £40,300) respectively. In determining the percentage rates to use in this sensitivity analysis the movements in the actual market rates of Euro and US Dollars during 2015 were taken into account. The above table incorporates all material currency risk to Profit before tax. Therefore, a 10% increase/decrease across all currencies could impact Profit before tax by up to £27,900 (2014: £41,000).

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

5. Capital management and risk management and control (continued)

Credit Counterparty risk

Credit risk is the risk that a counterparty fails to meet its contractual obligations in full as they fall due, resulting in a financial loss to the Company. The key areas of exposure to credit risk for the Company are in relation to its investment portfolio and reinsurance programme and amounts due from insurance intermediaries and policyholders.

The Company structures the levels of credit risk it accepts by placing limits on its exposure to a single counterparty, or groups of counterparties, and to geographical and industry segments.

Investments are primarily allowed only in liquid securities and with counterparties that have a credit rating equal to investment grade or better. Given their high credit ratings Management does not expect any counterparty to fail to meet its obligations. Counterparty exposure is subject to regular review.

Reinsurance exposures are monitored regularly. The Company assesses the credit worthiness of all reinsurers by reviewing public rating information and from internal investigations.

Exposure to insurance intermediaries risk is managed via a stringent credit policy. The Company's credit control function monitors the ageing and collectability of debtor balances, with credit evaluations performed on all relevant counterparties. Intermediary debt at 31 December 2015 was £35.7m (2014: £29.3m), all of which was not rated.

The Company also reduces its exposure to credit risk related to intermediaries by diversification through the use of a significant number of brokers.

In addition to the above the Company also monitors the debt via the Asset & Liability and Intermediary Collection Committees and provides against older debts.

The Company's exposure to credit risk by investment grade is summarised below:

	AAA	AA	A	BBB	Below BBB	Not rated	Total
Credit risk exposure 2015	£000	£000	£000	£000	£000	£000	£000
Debt and other fixed income securities	84,852	53,873	77,421	107,363	18,291	1,092	342,892
Short term bank deposits	-	50,297	102,513	42,784	15,002	-	210,596
Insurance receivables	-	-	91	-	-	35,687	35,778
Reinsurance assets	-	127,594	27,973	-	-	4,642	160,209
Total exposure	84,852	231,764	207,998	150,147	33,293	41,421	749,475

	AAA	AA	A	BBB	Below BBB	Not rated	Total
Credit risk exposure 2014	£000	£000	£000	£000	£000	£000	£000
Debt and other fixed income securities	174,638	114,645	120,676	115,841	812	-	526,612
Short term bank deposits	-	18,197	48,495	42,578	-	6,000	115,270
Insurance receivables	-	-	135	-	-	29,346	29,481
Reinsurance assets	-	41,161	44,047	-	-	3,565	88,773
Total exposure	174,638	174,003	213,353	158,419	812	38,911	760,136

HIGHWAY INSURANCE COMPANY LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015**

5. Capital management and risk management and control (continued)

Offsetting financial assets and financial liabilities

Financial assets and liabilities are offset in the Statement of Financial Position when the Company intends to apply a current legally enforceable right to offset. Master netting arrangements and cash collateral are utilised by the Company to minimise credit risk exposure.

The following financial assets and liabilities are subject to offsetting, enforceable master netting arrangements and similar agreements.

An analysis is included of netting arrangements which meet the offsetting criteria within IAS 32 and are set off in the Statement of Financial Position and also those which do not meet the criteria.

As at 31 December 2015	Amounts off set			Related amounts not off set		
	Gross assets	Gross liabilities offset	Net amounts presented	Financial Instruments	Cash Collateral received	Net amount
	£000	£000	£000	£000	£000	£000
Financial assets						
Derivative financial assets	610	-	610	-	610	-
Total	610	-	610	-	610	-

	Amounts off set			Related amounts not off set		
	Gross liabilities	Gross assets offset	Net amounts presented	Financial Instruments	Cash Collateral pledged	Net amount
	£000	£000	£000	£000	£000	£000
Financial liabilities						
Bank overdrafts	5,465	3,475	1,990	-	-	-
Total	5,465	3,475	1,990	-	-	-

As at 31 December 2014	Amounts off set			Related amounts not off set		
	Gross assets	Gross liabilities offset	Net amounts presented	Financial Instruments	Cash Collateral pledged	Net amount
	£000	£000	£000	£000	£000	£000
Financial assets						
Derivative financial assets	225 -	-	225 -	-	225 -	-
Total	225 -	-	225 -	-	225 -	-

	Amounts off set			Related amounts not off set		
	Gross liabilities	Gross assets offset	Net amounts presented	Financial Instruments	Cash Collateral pledged	Net amount
	£000	£000	£000	£000	£000	£000
Financial liabilities						
Derivative financial liabilities	11,853 -	-	11,853 -	-	11,380	473
Bank overdrafts	5,315	2,121	3,194 -	-	-	3,194
Total	17,168	2,121	15,047 -	-	11,380	3,667

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

5. Capital management and risk management and control (continued)

As at 31 December 2015, the fair value of collateral held was £0.7m (2014: £0.3m), in accordance with IFRS 7 the amount reported in the table above is limited to the amount of the derivative asset reported on the Statement of Financial Position.

No collateral received from the counterparty has been sold or repledged (2014: nil).

Collateral posted to Highway Insurance Company by the counterparty to a derivative contract which is valued as being 'in-the-money' can be drawn upon following certain events of default as defined in the relevant International Swaps and Derivatives Association (ISDA) agreement. This includes failure by the counterparty to comply with or perform any agreement or obligation defined in the ISDA or Credit Support Annex if such failure is not remedied within 30 days after notice of such failure is given. Bankruptcy of the counterparty to a trade could also result in collateral posted being drawn upon to mitigate any financial exposure to the Company.

The Company reviews the carrying value of its financial assets at each Statement of Financial Position date. If the carrying value of a financial asset is impaired, the carrying value is reduced through a charge to the Statement of Comprehensive Income. As at 31 December 2015 £0.4m (2014: £0.2m) was impaired which primarily relates to receivables where there is no realistic prospect of recovery. The tables below provides information regarding the maximum credit risk exposure to financial assets, together with the extent to which they are due, overdue and impaired. The table also shows the age analysis of the Company's past due and/or impaired assets.

	<31 days	31 to 60 days	61 to 90 days	>90 days	Total past due but not impaired	Past due and impaired	Neither past due nor impaired	Total
Age analysis of assets past due/impaired 2015	£000	£000	£000	£000	£000	£000	£000	£000
Insurance receivables	2,302	709	205	(21)	3,195	351	32,232	35,778
Loans and other receivables	-	-	-	-	-	-	3,153	3,153

	<31 days	31 to 60 days	61 to 90 days	>90 days	Total past due but not impaired	Past due and impaired	Neither past due nor impaired	Total
Age analysis of assets past due/impaired 2014	£000	£000	£000	£000	£000	£000	£000	£000
Insurance receivables	2,268	691	251	230	3,440	245	25,796	29,481
Loans and other receivables	-	-	-	-	-	-	11,910	11,910

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

5. Capital management and risk management and control (continued)

Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with its financial and insurance contract liabilities. The Company is exposed to daily calls on its cash resources from claims arising from insurance contracts it has underwritten.

The Company has a liquidity risk appetite policy which requires that sufficient liquid resources are maintained to cover net cash outflows both on a business as usual basis and under stressed conditions. The most significant payments made are claims, the payment profile of which is predictable. The Company maintains cash and liquid deposits to meet demands on a daily basis. In normal circumstances, the majority of claims are settled from cash received from intermediaries.

The Company forecasts cash flows on a daily basis to ensure that sufficient liquid funds exist to meet its short term cash outflows. Any surplus funds are invested to achieve a higher rate of return.

The majority of investments are held in assets that are traded in active markets.

The table below summarises the expected recovery or settlement of assets:

Maturity profile of financial assets	2015			2014		
	Within 1 year	Over 1 year	Total	Within 1 year	Over 1 year	Total
	£000	£000	£000	£000	£000	£000
Financial Assets						
- Fair value through income	257,281	239,641	496,922	481,586	124,838	606,424
- Derivative financial instruments	610	-	610	225	-	225
Loans and other receivables	3,153	-	3,153	11,910	-	11,910
Reinsurers' share of claims outstanding	29,336	130,734	160,070	30,658	57,896	88,554
Insurance receivables	35,778	-	35,778	29,481	-	29,481
Accrued interest	5,966	-	5,966	9,294	-	9,294
Cash and cash equivalents	231,765	-	231,765	121,114	-	121,114
	563,889	370,375	934,264	684,268	182,734	867,002

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

5. Capital management and risk management and control (continued)

The table below summarises the estimated maturity profile of the financial liabilities and equity of the Company based on remaining undiscounted obligations:

	Within 1 year	1-3 years	3-5 years	Over 5 years	Total
Maturity profile of financial liabilities 2015	£000	£000	£000	£000	£000
Insurance contract liabilities	165,961	125,637	47,426	88,534	427,558
Provisions	11	-	-	-	11
Financial liabilities					
- Derivative Financial Instruments	23	-	-	-	23
- Other financial liabilities	680	-	-	8,844	9,524
Insurance payables	68,295	-	-	-	68,295
Trade and other payables - excluding tax and social security costs	9,694	-	-	-	9,694
	244,664	125,637	47,426	97,378	515,105

	Within 1 year	1-3 years	3-5 years	Over 5 years	Total
Maturity profile of financial liabilities 2014	£000	£000	£000	£000	£000
Insurance contract liabilities	161,277	145,625	47,753	71,521	426,176
Provisions	11	-	-	-	11
- Derivative Financial Instruments	11,863	-	-	-	11,863
- Other financial liabilities	250	-	-	9,313	9,563
Insurance payables	847	-	-	-	847
Trade and other payables - excluding tax and social security costs	12,718	-	-	-	12,718
	186,966	145,625	47,753	80,834	461,178

Fair value estimation

The following fair value estimation tables present the Company's assets and liabilities measured at fair value by level of the fair value measurement hierarchy at 31 December 2015.

The fair value of financial instruments included in the level 1 category below are based on published quoted bid market prices in an active market at the year end date. A market is regarded as an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Level 2 financial instruments are not traded in an active market or their fair value is determined using valuation techniques. These valuation techniques apply data from observable current market transactions where it is available, and for some pricing is obtained via pricing services. Where prices have not been determined by reference to an active market, financial assets with fair values are based on broker quotes.

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

5. Capital management and risk management and control (continued)

Fair value estimation (continued)

Specific valuation techniques used to value financial instruments classified as level 3 include:

- Quoted market prices or dealer quotes for similar instruments (unlisted shares)
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves of similar instruments.
- The fair value of forward exchange contracts is determined using forward exchange rates at the statement of financial position date, with the resulting value discounted back to present value.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instrument.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

There were no changes to the valuation techniques during the year.

There were no transfers between levels 1 and 2 during the year.

The Company's policy is to recognise transfers into and out of fair value hierarchy levels as of the date of the event or change in circumstances that caused the transfer.

The valuation of all of the Company's investment holdings is performed by independent and qualified valuers.

Any changes to fair value are recognised within net gains/losses on investments within the statement of comprehensive income with the exception of investment contract liabilities where the movement is recognised within the gross change in contract liabilities.

The following table presents the Company's assets and liabilities measured at fair value at 31 December:

	2015				2014			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Fair value through income								
Shares, other variable yield securities and units in unit trusts	4,205	149,640	185	154,030	9,883	69,509	420	79,812
Debt and other fixed income securities	3,280	339,612	-	342,892	64,609	462,003	-	526,612
Derivative financial instruments	-	(23)	610	587	-	215	(11,853)	-11,638
Collateral received	(680)	-	-	(680)	(250)	-	-	(250)
Subordinated note	-	-	-	-	-	(9,313)	-	(9,313)
	6,805	489,229	795	496,829	74,242	522,414	(11,433)	585,223

HIGHWAY INSURANCE COMPANY LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015**

5. Capital management and risk management and control (continued)

Movement in level 3 instruments measured at fair value:

	Fair value through income	Derivative financial instruments	Total
	£000	£000	£000
Balance at 1 January 2015	420	(11,853)	(11,433)
Total (loss)/gain recorded in statement of comprehensive	(246)	12,275	12,029
Movement in write off provision	247	-	247
Purchases	(236)	1,459	1,223
Sales	-	(1,271)	(1,271)
Balance at 31 December 2015	185	610	795

	Fair value through income	Derivative financial instruments	Total
	£000	£000	£000
Balance at 1 January 2014	614	2,641	3,255
Total gain/(loss) recorded in statement of comprehensive	19	(15,707)	(15,688)
Movement in write off provision	195	-	195
Purchases	-	1,213	1,213
Sales	(408)	-	(408)
Balance at 31 December 2014	420	(11,853)	(11,433)

Sensitivities of level 3 investments

Changing the inputs for the Company's level 3 assets would not significantly change the fair value.

HIGHWAY INSURANCE COMPANY LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015**

5. Capital management and risk management and control (continued)

Information about fair value measurements using significant unobservable inputs (Level 3):

Description	Fair value at 31 December 2015 £000	Valuation technique(s)	Unobservable inputs	Range of unobservable inputs (probability weighted average)	Relationship of unobservable inputs to fair value
Financial assets held at fair value through income					
Shares, other variable yield securities and units in unit trusts					
- Overseas unlisted	185	N/A*	N/A*	N/A*	N/A*
Equity/Index derivative	610				
Financial liabilities					
Derivative financial instruments					
Gilt yield hedge					
<hr/>					
Description	Fair value at 31 December 2014 £000	Valuation technique(s)	Unobservable inputs	Range of unobservable inputs (probability weighted average)	Relationship of unobservable inputs to fair value
Financial Assets held at fair value through income					
Shares, other variable yield securities and units in unit trusts					
Overseas unlisted	420	N/A*	N/A*	N/A*	N/A*
Financial Liabilities					
Derivative financial instruments					
Gilt yield hedge	11,853	Mark-to-model	Gilt repo rates	The range on market gilt repo rates offered can be up to 10bps	A gilt repo rate increase will result in a lower contract value

* Due to the nature of these holdings the quantitative unobservable inputs are not developed by the entity when measuring fair value, and in accordance with IFRS 13 paragraph 93 (d) the Company has not disclosed the relevant information.

5. Capital management and risk management and control (continued)

Operational risk

Operational risk is the risk of loss, resulting from inadequate or failed internal processes, people and systems, or from external events, including legal and regulatory risk.

Senior managers are responsible for the identification, assessment, control and monitoring of operational risks and for reporting these to the Risk Committee in accordance with the Company's escalation criteria. Operational risks are assessed in terms of their probability and impact in accordance with Company policy.

Strategic risk

Strategic risk is the risk arising from ineffective, inefficient, or inadequate senior management process for the development and implementation of business strategy in relation to the business environment and the group's capabilities.

The strategic risks of the business are assessed and managed by the business risk committees which then report these and other significant risks to the LVFS Group Executive Risk Committee, where the risks are reviewed and challenged. The LVFS Chief Risk Officer reports on a group basis all strategic risks to the LVFS board's risk committee.

Group risk

Group risk is the risk of contagion incurred from its membership of a group of firms. The LVFS Group Executive Risk Committee oversees the management of such risks.

The Company has not identified any significant group risks.

HIGHWAY INSURANCE COMPANY LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015**

6. Net premium revenue

	2015	2014
	£000	£000
Insurance contracts		
Premiums written	329,853	305,024
Change in unearned premium reserve	(14,387)	2,196
Premium revenue arising from insurance contracts issued	315,466	307,220
Reinsurance contracts		
Premiums payable	(76,123)	(6,686)
Change in unearned premium reserve	(80)	48
Premium revenue ceded to reinsurers on insurance contracts issued	(76,203)	(6,638)
Net premium revenue	239,263	300,582
Motor	208,672	210,329
Commercial	106,794	96,628
Other	-	263
	315,466	307,220

As at the 31 December 2015 the Company entered into a Loss Portfolio Transfer Agreement resulting in reinsurance of 20% of its booked reserves. This has had an impact of £66.9m on Reinsurance contracts Premiums payable.

7. Investment income

	2015	2014
	£000	£000
Income from investments and cash and cash equivalents		
- Interest on loans and receivables	170	113
- Interest income	20,659	23,266
- Dividend income	2,557	2,069
	23,386	25,448

8. Net fair value losses on financial assets at fair value through income

	2015	2014
	£000	£000
(Losses)/gains on financial assets at fair value through income		
- Debt securities	(14,709)	(746)
- Equity securities	1,344	2,996
- Derivative financial instruments	(864)	(14,481)
	(14,229)	(12,231)

Net fair value (losses)/gains on financial assets at fair value through income include net realised losses of £14,980,000 (2014: Gain £2,271,000) and net unrealised gains of £752,000 (2014: Loss £14,502,000).

9. Other income

	2015	2014
	£000	£000
Commission income	596	724
	596	724

HIGHWAY INSURANCE COMPANY LIMITED**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015****10. Insurance claims and loss adjustment expenses**

	2015	2014
	£000	£000
Gross insurance claims		
Claims paid during the year	216,912	242,829
Claims management costs	11,008	11,118
Movement in claims liabilities	1,382	(59,323)
	229,302	194,624
Reinsurers' share of gross insurance claims		
Current year claims and loss adjustment expenses	(1,886)	(6,885)
Movement in reinsurers' share on claims liabilities	(71,516)	4,072
	(73,402)	(2,813)
Net insurance claims	155,900	191,811

Included within claims incurred is a decrease of £19.5m in respect of motor insurance business (2014: £34.7m) , being the difference between the provision for claims outstanding at the beginning of the year less payments made in respect of claims incurred in prior years and the claims outstanding at the end of the year in respect of those claims. These have been calculated excluding margin.

As at 31 December 2015 the Company entered into a Loss Portfolio Transfer Agreement resulting in reinsurance of 20% of its booked reserves. This has had an impact of £66.9m on the Movement in reinsurers' share of claims liabilities.

11. Finance costs

	2015	2014
	£000	£000
Interest payable	319	389
	319	389

12. Other operating and administrative expenses

	2015	2014
	£000	£000
Investment management expenses and charges	1,296	1,258
Acquisition expenses	52,865	49,665
Movement in deferred acquisition costs	(1,867)	277
Auditors' remuneration	215	175
Impairment of insurance receivables	374	311
Administrative expenses	36,492	36,910
	89,375	88,596

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

13. Auditors' remuneration

	2015 £000	2014 £000
Audit of the Company	189	150
Audit related assurance services	26	25
	215	175

There were no other services carried out by the Auditors in respect of the Company.

14. Directors' emoluments

The Directors of the Company are remunerated by LVFS or LV Insurance Management Limited.

The details of Directors' emoluments below include the total emoluments of those Directors who have a role in the wider LVFS group, as well as providing service to the Company. It is not possible to make an accurate apportionment of these emoluments in respect of each of the subsidiaries within the LVFS group.

The aggregate amount of Directors' emoluments was as follows:

	2015 £000	2014 £000
a) Aggregate emoluments	42,627	6,268

b) Emoluments of the Directors were as follows:

	Fees and Salaries £000	Bonus £000	Deferred bonus * £000	Other benefits £000	Long term incentive plan £000	2015 Total £000	2014 Total £000
Highest paid Director	300	235	-	81	10,126	10,742	1,666
All Directors	3,429	2,232	399	709	35,858	42,627	6,268

* Deferred bonus represents the amount of the 2015 performance bonus payable over the next three years.

Other benefits include payments in lieu of pension contributions, life assurance, car allowances, medical, relocation and other benefits in kind or their equivalent monetary value.

LVFS has made no contributions to personal pension arrangements during 2015 or 2014.

Further details on the Long Term Incentive Plan are disclosed within the Financial Statements of LVFS.

c) Pension arrangements

The LV= Employee Pension Scheme is administered at LVFS group level and incorporates both a defined benefit section and defined contribution section. The defined benefit section was closed to future accrual in 2013 at which point existing members were eligible to join the defined contribution section.

In 2015 there were £73,371 of contributions to the defined contribution section (2014: £87,474).

Further details of the LV= Employee Pension Scheme are disclosed within the financial statements of LVFS.

	2015 £000	2014 £000
Deferred pension at end of period	210	231

HIGHWAY INSURANCE COMPANY LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015**

15. Income tax expense

a) Current year tax expense

	2015	2014
	£000	£000
Current year tax expense		
Corporation tax	136	6,754
Adjustment to current tax in respect of prior years	-	(4)
Total current tax	136	6,750
Deferred tax		
Deferred tax credit	48	51
Total deferred tax	48	51
Total income tax expense	184	6,801

b) Reconciliation of tax expense

The tax assessed for the period is lower than the standard rate of corporation tax in the UK (20.25%). The differences are explained below:

	2015	2014
	£000	£000
Profit before tax	3,422	33,727
Profit multiplied by standard rate of corporation tax in the UK of 20.25% (2014: 21.5%)	693	7,251
Effects of:		
Impact of change in UK corporation tax rate on deferred tax	9	-
Adjustment to current tax in respect of prior years	-	(4)
Income not subject to corporation tax	(518)	(446)
Total income tax expense for the year	184	6,801

The standard rate of corporation tax in the UK changed from 21% to 20% with effect from 1 April 2015. Accordingly, the profits for this accounting year are taxed at an effective rate of 20.25%.

The standard rate of corporation tax in the UK changed from 21% to 20% with effect from 1 April 2015. Accordingly, the profits for this accounting year are taxed at an effective rate of 20.25%.

Further reductions to the standard rate of corporation tax in the UK have been announced. With effect from 1 April 2017 the standard rate of corporation tax in the UK will be 19%. With effect from 1 April 2020 the standard rate of corporation tax in the UK will be 18%. These changes had not been substantively enacted at the balance sheet date and, therefore, are not recognised in these financial statements.

16. Deferred acquisition costs

	2015	2014
	£000	£000
At 1 January	24,567	24,844
Acquisition expenses deferred	52,865	49,665
Amortisation	(50,998)	(49,942)
At 31 December	26,434	24,567

HIGHWAY INSURANCE COMPANY LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015**

17. Current tax asset / (liability)

	2015	2014
	£000	£000
At 1 January	(3,100)	(1,846)
Amounts recorded in the statement of comprehensive income	(136)	(6,750)
Income tax paid	5,100	5,496
At 31 December	1,864	(3,100)

18. Deferred tax asset

	2015	2014
	£000	£000
At 1 January	215	266
Current year charge	(48)	(51)
At 31 December	167	215

Analysis of deferred taxation temporary differences:

	2015	2014
	£000	£000
Accelerated capital allowances	167	215
	167	215

The analysis of the deferred tax balance is as follows:

	2015	2014
	£000	£000
Deferred tax asset expected to be recovered after more than 12 months	135	176
Deferred tax asset expected to be recovered within 12 months	32	39
Net deferred tax asset	167	215

The valuation and recoverability of deferred tax assets relating to capital allowances in excess of depreciation is dependent on the availability of future taxable profits within the company. Management forecasts currently support the future recoverability of the deferred tax asset recognised in the balance sheet as at 31st December 2015.

The calculation of deferred tax balances at the year end also takes into account the reduction in the UK main corporation tax rate to 20%, effective from 1 April 2015, and further reductions to 19% and 18%, both substantively enacted on 26 October 2015, that will be effective from 1 April 2017 and 1 April 2020 respectively.

19. Prepayments and accrued income

	2015	Restated - see note 2 2014
	£000	£000
Accrued interest	5,966	9,294
Prepayments	422	477
	6,388	9,771

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

20. Financial assets

	2015 £000	2014 £000
Fair value through income		
Shares, other variable yield securities and units in unit trusts	154,030	79,812
Debt and other fixed income securities	342,892	526,612
	496,922	606,424

21. Derivative financial instruments

The Company utilises the following derivative instruments for hedging the effects of changes in the FTSE 100 index on its equity and movements in the yield curve on the market value of its fixed interest portfolio. Fair values are estimated using current market index data and are included in assets/liabilities as set out in the following table:

	2015			2014		
	Contract/ notional amount £000	Fair value - asset £000	Fair value - liability £000	Contract/ notional amount £000	Fair value - asset £000	Fair value - liability £000
Forward exchange contracts	862	-	(23)	32,000	225	-
Contracts for differences (gilt yield hedge)	-	-	-	529,000	-	(11,853)
Equity/Index derivatives	59,177	610	-	-	-	(10)
	60,039	610	(23)	561,000	225	(11,863)

The carrying amounts disclosed above reasonably approximate fair value at the Statement of Financial Position date.

As a result of the use of the above derivative instruments the Company's asset portfolio was protected from; a significant fall in value of the UK equity market throughout 2015, and gilt yield movements until 30th June 2015. The fair value liability is a result of gilt yields remaining lower for longer and not following the forward curve implied at inception of the hedge. This liability is offset by an increase in the value of the underlying corporate bond holdings between 31 December 2014 and 30 June 2015.

22. Loans and other receivables

	2015 £000	2014 £000
Other receivables	3,153	530
Cash Collateral pledged	-	11,380
	3,153	11,910

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

23. Reinsurance assets

	2015 £000	2014 £000
Reinsurers' share of provision for unearned premiums	139	219
Reinsurers' share of claims outstanding	93,199	88,554
Reinsurance - Claims Outstanding LPT	66,871	-
	160,209	88,773

Amounts due from reinsurers in respect of claims already paid by the Company on the contracts that are reinsured are included in insurance receivables.

In the latter part of 2015 the Company entered into a Loss Portfolio Transfer Agreement resulting in reinsurance of 20% of its booked reserves. This has had an impact of £66.9m on the reinsurers' share of claims outstanding.

24. Insurance receivables

	2015 £000	2014 £000
Receivables arising from insurance and reinsurance contracts		
- Due from agents, brokers and intermediaries	35,687	29,346
- Due from reinsurers	91	135
	35,778	29,481

25. Cash and cash equivalents

	2015 £000	2014 £000
Bank balances	21,169	5,844
Short term bank deposits	210,596	115,270
Cash and cash equivalents per statement of financial position	231,765	121,114
Bank overdrafts	(1,990)	(3,194)
Cash and cash equivalents per statement of cash flows	229,775	117,920

HIGHWAY INSURANCE COMPANY LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015**

26. Insurance contract liabilities

a) Analysis of insurance contract liabilities

	2015			2014		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
General insurance claims liabilities	427,558	(160,070)	267,488	426,176	(88,554)	337,622
General insurance unearned premiums	165,140	(139)	165,001	150,753	(219)	150,534
	592,698	(160,209)	432,489	576,929	(88,773)	488,156

b) Movement in general insurance claims liabilities

	2015			2014		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
OCR	400,636	(38,771)	361,865	442,607	(41,907)	400,700
IBNR	25,540	(49,783)	(24,243)	42,893	(50,720)	(7,827)
Balance at 1 January	426,176	(88,554)	337,622	485,500	(92,627)	392,873
Movement in claims incurred in prior accident years	(27,190)	(34,656)	(61,846)	(39,421)	(542)	(39,963)
Claims incurred in the current accident year	245,484	(38,746)	206,738	222,926	(2,270)	220,656
Claims paid during the year	(216,912)	1,886	(215,026)	(242,829)	6,885	(235,944)
	1,382	(71,516)	(70,134)	(59,324)	4,073	(55,251)
Balance at 31 December	427,558	(160,070)	267,488	426,176	(88,554)	337,622
OCR	422,044	(115,953)	306,091	400,636	(38,771)	361,865
IBNR	5,514	(44,117)	(38,603)	25,540	(49,783)	(24,243)
Balance at 31 December	427,558	(160,070)	267,488	426,176	(88,554)	337,622

c) Movement in general insurance unearned premiums

	2015			2014		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	150,753	(219)	150,534	152,949	(171)	152,778
Premiums written in the year	329,853	(76,122)	253,731	305,024	(6,686)	298,338
Premiums earned during the year	(315,466)	76,202	(239,264)	(307,220)	6,638	(300,582)
Balance at 31 December	165,140	(139)	165,001	150,753	(219)	150,534

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

26. Insurance contract liabilities (continued)

Details of the methodologies used for the premium and claims provisions for products administered on the main underwriting system are provided below. These products represent over 90% of the Company's liabilities.

Outstanding Claims Reserve ('OCR')

The purpose of the OCR is to ensure adequate reserves are in place for known claims. It is calculated by aggregating the case reserves for all known claims and is calculated as part of the quarterly actuarial reserve review. However, the aggregated case reserves may be deemed to be over or understated against the expected ultimate settlement cost of the known claims and this is allowed for in the IBNR calculation.

Incurred But Not Reported Reserve ('IBNR')

The purpose of the IBNR reserve is to reflect the additional claims cost from claims incurred but not reported before the statement of financial position date, known as 'pure IBNR' and the cost of any over or understatement in the OCR, known as Incurred But Not Enough Reported ('IBNER').

IBNR is calculated as part of the quarterly actuarial reserve reviews using a combination of statistical/actuarial techniques.

These projections are performed on homogeneous groups of claim types. Otherwise, the projections would be prone to error from changes in mix by claim type. The claim types modelled are:

- Accidental Damage
- Fire & Theft
- Windscreen
- Third Party Property Damage
- Third Party Personal Injury

Unearned Premium Reserve ('UPR')

The UPR is that proportion of premium received on in-force contracts that relates to unexpired risks at the statement of financial position date. This calculation is based on a monthly pro-rata basis and forms part of the insurance contract liabilities balance in the Statement of Financial Position.

27. Provisions

	2015	2014
	£000	£000
At 1 January	11	340
Releases	-	(329)
Balance at 31 December	11	11

2014 releases relate to an indirect taxation provision.

HIGHWAY INSURANCE COMPANY LIMITED**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015****28. Other financial liabilities**

	2015	2014
	£000	£000
Cash Collateral received	680	250
Subordinated note	8,844	9,313
	9,524	9,563

€12,000,000 subordinated note is repayable to Merrill Lynch in 2034. Interest is payable at the 3 month euro deposit rate plus a margin of 3.65%.

29. Insurance payables

	2015	2014
	£000	£000
Due to brokers and intermediaries	6	-
Due to policyholders	56	-
Due to reinsurers	68,233	847
	68,295	847

In the latter part of 2015 the Company entered into a Loss Portfolio Transfer Agreement resulting in reinsurance of 20% of its booked reserves. This has had an impact of £66.9m on the amounts due to reinsurers.

30. Trade and other payables

	2015	2014
	£000	£000
Bank overdrafts	1,990	3,194
Amounts owed to group undertakings	1,577	3,567
Accruals and deferred income	5,825	5,611
Other taxes and social security costs	6,676	4,317
Trade payables	43	133
Other payables	258	213
	16,369	17,035

31. Share capital

	2015	2014
	£000	£000
Ordinary shares, allotted and fully paid		
75,000,000 (2014: 75,000,000) ordinary shares of £1 each	75,000	75,000

All authorised shares have been issued.

HIGHWAY INSURANCE COMPANY LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2015**

32. Capital reserve

	2015	2014
	£000	£000
Balance at 1 January	150,000	150,000
Balance at 31 December	150,000	150,000

The reserve was created to receive capital contributions from its parent company LVGIG, in order to provide regulatory capital.

The capital reserve is distributable in future periods, subject to the provisions of the Companies Act 2006.

33. Retained earnings

	2015	2014
	£000	£000
Balance at 1 January	48,132	21,206
Profit for the year	3,238	26,926
Balance at 31 December	51,370	48,132

34. Cash generated from / (used in) operating activities

	2015	2014
	£000	£000
Profit before tax	3,422	33,727
Investment income	(23,386)	(25,448)
Finance costs	319	389
Losses on financial assets recorded in the statement of comprehensive income	14,229	12,231
Exchange (gains)/ losses on financial assets recorded in the statement of comprehensive income	(468)	(671)
Non-cash items		
Expenses deferred during the year	(1,867)	277
Changes in working capital		
Decrease / (Increase) in loans and other receivables	8,757	(10,723)
(Increase) / Decrease in reinsurance assets	(71,435)	4,025
(Increase)/decrease in insurance receivables	(6,297)	(29)
Decrease in prepayments and accrued income	55	135
Increase / (Decrease) in insurance contract liabilities	15,769	(61,520)
Increase in provisions	-	(329)
Increase / (Decrease) in collateral received	430	(2,970)
Increase / (Decrease) in insurance payables	67,447	(192)
Increase in trade and other payables	539	1,388
Cash generated from/(used in) operating activities	7,514	(49,710)

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

35. Related party transactions

The Company enters into transactions with key management personnel in the normal course of business. All transactions are carried out on an arm's length basis. Details of significant transactions carried out during the year with related parties are as follows:

Key management personnel of the Group include all Directors, executive and non-executive, and senior management (the Board and the Executive Committee).

The summary of the compensation of key management personnel for the year is as follows:

	2015	2014
	£000	£000
Short-term employee benefits	6,769	5,705
Post employee benefits	73	87
Other long-term benefits	35,858	563
	42,700	6,355

The following transactions have taken place between the Company and LV Repair Services Limited:

	2015	2014
	£000	£000
Cost of repairs from LV Repair Services Limited	435	-
	435	-

The following transactions have taken place between the Company and LV Insurance Management Limited:

	2015	2014
	£000	£000
Management charge to the Company	51,629	50,504
	51,629	50,504

LV Insurance Management Limited provides management services to the Highway Insurance Company.

Balances outstanding between the Company and other LV= group companies:

	2015	2014
	£000	£000
Payable by the Company to LVFS	(1,577)	(3,567)
	(1,577)	(3,567)

HIGHWAY INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

36. Ultimate parent company

The ultimate parent company and the ultimate controlling party is Liverpool Victoria Friendly Society Limited, a UK incorporated Friendly Society registered under the Friendly Societies Act 1992.

The immediate parent company is Highway Insurance Group Limited, a limited liability company, incorporated in the UK.

Both the ultimate and immediate parent companies are registered at the below address.

The largest company whose accounts this company is consolidated into is Liverpool Victoria Friendly Society Limited.

The smallest company whose accounts this company is consolidated into is Liverpool Victoria General Insurance Group Limited.

The consolidated accounts of Liverpool Victoria Friendly Society Limited are available to the public and may be obtained from:

The Company Secretary
County Gates
Bournemouth
BH1 2NF

or at www.lv.com/about-us/company-information/returns/reports-accounts