COMPANY REGISTRATION NUMBER: 0003730662

HIGHWAY
INSURANCE COMPANY LIMITED

REPORT AND
FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

C O N T E N T S

DIRECTORS, OFFICERS AND REGISTERED OFFICE

Directors

P M Bunker	
S V Castle	
P A Horton	
P W Moore	
J B O'Roarke	
M J Rogers	
S R Haynes	
R A Warner	
W M Mayall	Appointed 16 November 2012
S C A Fernandes	Appointed 16 November 2012

Company secretary

P B Cassidy	Resigned 1 January 2013
R S Small	Appointed 1 January 2013

Registered office

County Gates
Bournemouth
United Kingdom
BH1 2NF

Tel: 01202 292333
Fax: 01202 751825

Independent Auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
31 Great George Street
Bristol
BS1 5QD

DIRECTORS' REPORT

The Directors present their annual report and the audited financial statements of Highway Insurance Company Limited (the ‘Company’, ‘HICO’) for the year to 31 December 2012.

1. Results and dividends

The profit for the year was £22,452,000 (2011: £19,928,000) as set out on page 9. The Directors proposed and paid no dividends in the current year (2011: £nil).

2. Principal activities

The principal activity of the Company is to carry on general insurance business through the broker distribution channel. The primary sources of premium income are from the sale of motor insurance products. Motor insurance products include private car, specialist, fleet, motorcycle and commercial vehicles.

3. Business review and developments

(a) Results & performance

The 2012 results for the Company show a profit before taxation of £29,535,000. This continues the profitable growth trend reported over recent years and demonstrates that the Company results are progressing in line with strategic objectives.

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

1. Premium income growth: UK motor market conditions prevalent in 2012 (increased market pricing competition and continued decline in price levels) led to the decision not to pursue excessive business volumes at the expense of margins and because of this decision the Company has seen premium income decline in 2012. The Management’s aim was to concentrate on margins rather than achieving growth.

2. Investment returns: Overall investment returns in 2012 have been strong and significantly improved compared with the prior year. The Company has benefited from positive operational cash flows, from having a spread of investment risk across a broad range of investment classes and from proactive asset management during the year.

3. Expenditure: Investment in staff, systems and infrastructure has continued ensuring that the Company is well placed to deliver its profitable growth strategy.

4. Underwriting and Claims: During 2012 the Company has continued to develop its products and improve pricing and underwriting activities. Significant work has been done in the claims area aimed at improving the efficiency of systems and claims processes and in reducing claims leakage. In Motor the benefits of a reduction in the frequency of car accidents were offset by a continued increase in personal injury (‘PI’) claims and fraudulent claims numbers. We have adopted a strongly proactive strategy to claims management. Our policy is to settle valid claims in full as rapidly as possible, while at the same time adopting a rigorous and challenging approach to suspect claims.

(b) Business environment
2012 saw increased competition returning to the UK insurance market, particularly the UK motor market, and prices moved down as the year progressed. In relation to the motor personal lines market, which is the Company's major line of business, price reductions averaged c10% during 2012.

Competitive pressures are expected to continue into the early part 2013. However there are a number of offsetting factors, including legal and regulatory impacts, which mean that the eventual outcome by the end of 2013 is very uncertain (e.g. Market Prices could end higher or lower).

(c) Strategy
The Company is a major part of the Liverpool Victoria General Insurance Group ('LVGIG'). The long term objective of LVGIG (and its subsidiaries) 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 Commercial 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 members of Liverpool Victoria Friendly Society ('LVFS')."

The Company makes its contribution to the LVGIG strategic objectives through the broker distribution channel.

(d) Principal risks and uncertainties
UK Insurance Market - Pricing: The UK motor insurance market moves in a cyclical manner and is currently experiencing increased price competition as a number of companies are now aiming for increased market share. The main driver for this is that some companies are now starting to see a return to acceptable underwriting margins. It is anticipated that the market will remain competitive during the early part of 2013. However a number of uncertainties remain (see regulatory section below) which will impact the eventual 2013 out turn.

UK Insurance Market – Claims: The UK motor market continues to see increased PI claims driven by referral fee processes and claims management companies. We anticipate that increased PI claims activity will continue during 2013. We are proactively managing our claims to limit the impact of this market characteristic as much as possible. The use of periodic payment orders (PPOs) to settle large disability claims is also continuing to become more common; again this trend is likely to continue into the future. Management is monitoring and managing this area very closely.

Economic Environment: The improved financial environment during the second half of 2012 has meant that markets have rallied towards the end of the year. However significant uncertainties remain going into 2013. Expectations for investment income over the next few years are to gradually return to a normalised level; however the market is also likely to see some volatility at times. The Company is paying, and will continue to pay, particular attention to credit risk. Capital management and cash flow also remains a material consideration at all times.

Regulatory: A number of legal and regulatory developments have started to affect the UK insurance market during 2012 and will increasingly have an impact in 2013 as the year progresses. These include 1. Competition Commission ('OFT') review of general insurance; 2. Legal Aid, Sentencing and Punishment of Offenders Act – the proposed banning of referral fees, reduced fixed solicitor's costs and extension of the Road Traffic Accident portal; 3. Consideration being given to changing the Ogden discount rate; 4. The delayed timetable for Solvency II implementation; and finally 5. Retail Conduct Risk Outlook ('RCRO') - The Financial Services Authority ('FSA') (soon to be FCA) publishes its RCRO each March, setting out the key risks that face each sector of the financial services industry. Management is continually monitoring all developments and taking appropriate action to ensure that the Company is well prepared. As part of its usual risk management processes, LV= reviews the document on publication and assesses its internal products, processes and controls against the risks that the FSA identifies. Conclusions from that review form part of the LV= view on the risks that it faces in the market.

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

Distribution: The increased influence of the internet and of aggregators has changed and continues to change the business operating environment. Social media trends are also becoming a material factor to the way the Company conducts the business, and therefore are being monitored closely. Finally, insurance specific developments in Telematics, although in their infancy, are another potential driver of material market transformation in the future. The Company is ensuring that it is prepared to respond very quickly to changing circumstances.

Exceptional Weather Events: Exceptional weather events will always present a risk to an insurance company. The Company mitigates this risk as far as is economically possible through the placing of reinsurance protection.

A statement of how the Company 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 steadily continue to increase its premium income in 2013 and beyond. This growth will come from moderate volume increases from Broker operations. However it should be noted that the volume growth will not be pursued at the expense of lower margins.

(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.

(g) Key performance indicators

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. During 2012, the KPIs were focused on premium income growth, and continued profitable growth.

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

KPI	2012	2011	Comments
Premiums written	£332m	£395m	The increased market pricing competition and continued decline in price levels led to the decision not to pursue excessive business volumes at the expense of margins. As a result of this decision, premiums written show a year on year decline.
Underwriting loss ratio	78.7%	78.0%	An overall loss ratio of 78.7% was reported for 2012. The year was affected by an adverse large loss claims experience and the impact of various legal and regulatory developments.
Expense ratio *	24.1%	20.0%	The net expense ratio (including other income) experienced an adverse movement during 2012. Main factors contributing to this were: 1) Lower net earned premiums 2) Changed business mix, with renewals attracting higher commission rates.
Combined ratio	102.8%	98.0%	The combined ratio of 102.8% is a result of increases in both the expense and loss ratios. An adverse level of large claims experience during 2012 combined with lower premiums and changed business mix were the main contributing factors.
Investment return	£41m	£19m	Total investment return includes: 1. Investment income and 2. Net fair value gains/losses on financial assets The total investment return has more than doubled compared with 2011. The Company has benefitted from a general uplift in markets towards the end of 2012. The Company has benefitted from increased funds under management and a proactive investment management strategy.
Net assets	£230m	£207m	Net assets have increased during 2012 to £230m reflecting the strong post tax profits made by the Company in 2012.

* Expense ratio excludes investment management costs.

4. Directors and their interests
The Directors of the Company who were in office during the year and up to the date of signing the financial statements are listed on page 1.

5. 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.

6. Employees
The Company did not directly employ any staff during 2012. Instead it utilised the staff and premises of LVFS in carrying out its activities and incurred the cost of staff through intercompany management charges.

7. Charitable and political donations
No charitable or political donations have been made by the Company during 2012 (2011: £nil).

8. Disclosure of information to auditor
Each Director at the date of this report confirms that:

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

9. 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, the ultimate parent company, also purchased and maintained throughout the financial 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 1.

10. Directors’ responsibilities statement
The Directors are responsible for preparing the Directors’ report and the financial statements in accordance with applicable law and regulations.

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

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on a 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.

On behalf of the Board of Directors

S V Castle
Director

21 February 2013

We have audited the financial statements of Highway Insurance Company Limited for the year ended 31 December 2012 which comprise the Statement of Comprehensive Income, the Statement of Changes in Equity, the Statement of Financial Position, the Statement of Cash Flows and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 6, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2012 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

David Roper (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
31 Great George Street
Bristol
BS1 5QD

21 February 2013

HIGHWAY INSURANCE COMPANY LIMITED

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	2012 £000	2011 £000
Insurance contract premium revenue	6	**359,285**	398,108
Insurance contract premium ceded to reinsurers	6	**(6,062)**	(5,210)
Net premium revenue		**353,223**	392,898
Investment income	7	**27,627**	20,557
Net fair value gains/(losses) on financial assets at fair value through income	8	**13,268**	(1,144)
Other income	9	**2,872**	4,499
Total income		**396,990**	416,810
Insurance claims and loss adjustment expenses	10	**(307,951)**	(328,108)
Insurance claims and loss adjustment expenses recoverable from reinsurers	10	**29,863**	21,535
Net insurance claims		**(278,088)**	(306,573)
Finance costs	11	**(484)**	(496)
Other operating and administrative expenses	12	**(88,883)**	(83,236)
Total claims and expenses		**(367,455)**	(390,305)
Profit before tax		**29,535**	26,505
Income tax expense	15	**(7,083)**	(6,577)
Profit for the year attributable to the owners		**22,452**	19,928
Total comprehensive income for the year		**22,452**	19,928

All balances relate to continuing business.

The notes on pages 13 to 42 are an integral part of the financial statements.

HIGHWAY INSURANCE COMPANY LIMITED

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2012

		Attributable to equity holder of the Company			
		Share capital	**Retained earnings**	**Capital reserve**	**Total**
	Note	**£000**	**£000**	**£000**	**£000**
Balance at 1 January 2012		75,000	(17,939)	150,000	207,061
Profit for the year	32	-	22,452	-	22,452
Balance at 31 December 2012		**75,000**	**4,513**	**150,000**	**229,513**

		Attributable to equity holder of the Company			
		Share capital	Accumulated losses	Capital reserve	Total
	Note	£000	£000	£000	£000
Balance at 1 January 2011		75,000	(37,867)	150,000	187,133
Profit for the year	32	-	19,928	-	19,928
Balance at 31 December 2011		75,000	(17,939)	150,000	207,061

The notes on pages 13 to 42 are an integral part of the financial statements.

HIGHWAY INSURANCE COMPANY LIMITED

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2012

	Note	**2012** £000	2011 £000
Assets			
Deferred acquisition costs	16	**26,863**	28,619
Financial assets			
- Fair value through income	17	**662,560**	610,194
- Derivative financial instruments	18	**822**	53
Loans and other receivables	19	**15,460**	400
Insurance receivables	20	**30,892**	35,692
Reinsurance assets	21	**95,536**	73,058
Prepayments and accrued income	22	**10,132**	1,939
Deferred tax asset	23	**369**	4,304
Current tax asset	24	**3,434**	-
Cash and cash equivalents	25	**73,337**	130,399
Total assets		**919,405**	884,658
Liabilities			
Insurance contract liabilities	26	**666,076**	649,472
Financial liabilities			
- Other financial liabilities	27	**9,733**	10,023
Insurance payables	28	**784**	1,365
Trade and other payables	29	**13,299**	16,737
Total liabilities		**689,892**	677,597
Equity			
Share capital	30	**75,000**	75,000
Capital reserve	31	**150,000**	150,000
Retained earnings/(accumulated losses)	32	**4,513**	(17,939)
Total equity		**229,513**	207,061
Total liabilities and equity		**919,405**	884,658

The notes on pages 13 to 42 are an integral part of the financial statements.

These financial statements were approved by the Board of Directors on 21 February 2013.

Signed on behalf of the Board of Directors

J B O'Roarke
Director

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	2012 £000	Restated (see note 2) 2011 £000
Cash and cash equivalents at 1 January	25	**130,399**	50,109
Cash flows arising from:			
Operating activities			
Cash (used in)/generated from operating activities	33	**(69,861)**	59,025
Dividend income received		**9,176**	18,202
Interest received		**10,689**	3,884
Finance cost paid		**(484)**	(496)
Group relief paid	24	**-**	(325)
Income tax paid	24	**(6,582)**	-
Net cash (used in)/generated from operating activities		**(57,062)**	80,290
Net (decrease)/increase in cash and cash equivalents		**(57,062)**	80,290
Cash and cash equivalents at 31 December	25	**73,337**	130,399

The notes on pages 13 to 42 are an integral part of the financial statements.

1. General information

Highway Insurance Company Limited is a company limited by shares, domiciled 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 accounts of Highway Insurance Company Limited have been prepared in accordance with International Financial Reporting Standards (IFRS), as endorsed by the European Union ('EU') and the International Financial Reporting Interpretations Committee ('IFRIC') and also with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

These accounts 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.

The preparation of the accounts in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the accounts are disclosed in 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.

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 December 2006.

Restatement

The classification on the statement of cash flows has been amended to align with LVGIG and the comparative numbers within that and the cash generated from/(used in) operating activities note have been restated.

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 balance sheet 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 insurance risk in its general insurance business. 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 that they relate to.

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.

Investment income
Investment income includes dividends, interest from investments at fair value and interest on other receivables. Dividends are included on an ex-dividend basis. Investment expenses are included on an accruals basis. Interest income for financial assets that are not classified as "fair value through income" is recognised using the effective interest method. The effective interest rate is calculated at outset by discounting the asset's estimated cash flows back to their net carrying amount.

Fair value gains and losses on financial assets
Realised gains and losses on financial assets are calculated as the difference between net sales proceeds and purchase price.

Unrealised gains and losses on financial assets represent the difference between the valuation of fair value investments at the statement of financial position date and their purchase price or, if they have been previously revalued, their valuation at the last statement of financial position date. 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.

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. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. 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 is provided on temporary differences arising on investments in subsidiaries and associates, except where the Company controls the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Foreign currencies
Monetary assets and liabilities denominated in foreign currencies are translated to the functional currency of the company at rates of exchange ruling at the end of the year. 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 recognised within the statement of comprehensive income.

Deferred acquisition costs (DAC)
The costs of acquiring new business, which are incurred during the financial year, but where the benefit of such costs will be obtained in the following year, are deferred and recognised as an asset to the extent that they are recoverable out of margins in future matching revenues. Acquisition costs comprise direct and indirect costs incurred in writing new contracts.

Deferred acquisition costs are written off in line with the recognition of premiums. Commissions and other acquisition costs that relate to serving new contracts and renewing existing contracts are capitalised as an intangible asset. All other costs are expensed when they are incurred. The asset is subsequently amortised over the life of the policy as the premium is earned.

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 DAC. 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 DAC and by subsequently establishing an unexpired risk provision.

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.

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.

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

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. 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 though income and their accounting treatment is consistent with that of financial assets at fair value through income.

Insurance receivables and payables
Insurance receivables and payables are recognised when due and include amounts due from or to agents, brokers and insurance contract holders. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income. Insurance receivables and payables are initially recognised at fair value and subsequently held at amortised cost.

Loans and other receivables
Loans and other receivables are recognised when due and comprise amounts due to the Company from group undertakings and other receivables. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income. Loans and other receivables are initially recognised at fair value and then subsequently held at amortised cost.

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.

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 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) 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.

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.

Where there is objective evidence that the carrying value is impaired, the loss is recognised in the statement of comprehensive income for the period.

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 cash flow statement, cash and cash equivalents are as defined above but are shown net of outstanding bank overdrafts.

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. 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.

Trade and other payables
Trade and other payables are recognised when due and include amounts due to group undertakings and accruals. They are initially recognised at fair value and subsequently held at amortised cost.

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

CHANGES IN ACCOUNTING POLICIES

(i) New and amended standards adopted by the Company

There are no IFRSs or IFRIC interpretations that are effective for the first time for the financial year beginning on 1 January 2012 that would be expected to have a material impact on the company.

(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 2012, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the company, except the following set out below:

Amendment to IAS 1, ‘Financial statement presentation’ regarding other comprehensive income. The main change resulting from these amendments is a requirement for entities to group items presented in ‘other comprehensive income’ (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendments do not address which items are presented in OCI.

IFRS 13, ‘Fair value measurement’, aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements, which are largely aligned between IFRSs and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP.

IFRS 9, ‘Financial instruments’, addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and October 2010. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity’s business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity’s own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The company is yet to assess IFRS 9’s full impact and intends to adopt IFRS 9 no later than the accounting period beginning on or after 1 January 2015, subject to endorsement by the EU. The company will also consider the impact of the remaining phases of IFRS 9 when completed by the Board.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be 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 accounts.

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;
- 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.

Estimation of the ultimate cost of bodily injury claims is a complex process and cannot be done using conventional actuarial techniques. Significant factors that affect the trends that influence the bodily injuries estimation process are inconsistent court resolutions and jurisprudence that have broadened the intent and scope coverage of the protection offered in the insurance contracts issued by the Company. This factor is exacerbated by the geographical diversification of the Company's bodily injury claims. The current case law in all the territories in which the Company is exposed to these claims can be characterised as still evolving; it is unlikely that any firm direction will emerge in the courts' compensation methods in the near future. 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. A recent legislative development is the prevalence of Periodic Payment Order (PPO) claims. These claims 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 paid on a PPO basis, but in some cases the claimant will request such a settlement. Market data analysis suggests that circa 35% 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, 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.

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 HICO and across the wider Group. The Reserving 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 HICO's best estimate is assessed.

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 equity and borrowings, 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 financial stability;
(ii) To enable the Company's strategy to be implemented;
(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 Financial Services Authority.

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, plans would be developed to return such excess to shareholders.

Consistent with other insurers in the non-life industry, the FSA imposes two separate capital requirements on the Company: the Minimum Capital Requirement (MCR) as defined in the FSA regulations and reported publicly in the Company's Annual FSA return; and Individual Capital Guidance (ICG), which is entity specific and is derived using a more risk-related approach as set out in the FSA regulations. The ICG is calculated and updated by the FSA following its reviews on a regular basis of the Company's own Individual Capital Assessment (ICA).

The Company complied with all externally imposed capital requirements to which it was subject throughout the reporting period.

The Company had capital available of £229,513,000 (2011: £207,061,000), being net assets available to the Company.

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 FSA's Individual Capital Assessment (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.
- 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 is committing 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 insurance liabilities. 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. For Highway Insurance Company Limited these would primarily include large personal injury claims, but would also include exposure to significant weather events impacting motor business. 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 personal 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 (2011: £5.0m per claim).

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

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:

	2012			2011		
	Gross	**Reinsurance**	**Net**	Gross	Reinsurance	Net
	£000	**£000**	**£000**	£000	£000	£000
Motor	**407,962**	**(86,431)**	**321,531**	379,354	(67,920)	311,434
Commercial	**92,819**	**(8,998)**	**83,821**	77,557	(5,121)	72,436
Other	**96**	**-**	**96**	38	-	38
	500,877	**(95,429)**	**405,448**	456,949	(73,041)	383,908

The claims provision is the estimated cost of outstanding claims from expired risks. The provision is calculated largely from using our own 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. Periodic Payment Orders (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 very 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 two specific areas of uncertainty that it has explicitly allowed for within the claims provision but where the outcome could be worse than the amount allowed for. These are:

- Uncertainty in the proportion of claims identified by the Company as being likely to settle on a PPO basis that actually settle on a PPO basis.
- Uncertainty in relation to the Ogden discount rate

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 the claims. If all of these claims settled as PPOs, the reserves would deteriorate by £4.8m from the position shown above.

The Ogden discount rate is set by the Lord Chancellor. It is currently 2.5% but a revision is under consideration with a decision possible by late 2013. Whilst there are many views across the industry in terms of what the change should be, the general consensus is that a reduction in the rate is likely. The claims provision has included an allowance for a change in the Ogden discount rate, using a scenario based approach as for PPOs. The allowance is broadly equivalent to a reduction in the discount rate to 1.75%. If the discount rate was to reduce to 1.5%, the claims provision would deteriorate by £1.6m. A reduction to 1% would lead to a deterioration of £5.5m.

The claims provision is also sensitive to the number and cost of large motor claims (defined as greater than £1m), 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 £1m threshold. The claims provision allows for £8.7m of late reported / reserved large claims. Therefore, if three new claims at £5m each were reported, for example, this would lead to a £6.3m deterioration in the reserves, whereas one new £5m claim would lead to a £3.7m improvement.

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	2003	2004	2005	2006	2007	2008	Restated 2009	Restated 2010	Restated 2011	2012	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Initial estimate of net provision	135.6	186.4	185.3	184.5	186.7	208.4	231.0	247.8	286.4	282.5	
One year later	142.3	179.8	191.3	180.0	196.8	243.6	226.4	274.7	279.6		
Two years later	131.9	179.6	179.3	179.7	198.5	220.0	232.4	283.0			
Three years later	121.2	169.0	171.6	179.5	200.7	212.0	234.5				
Four years later	116.3	167.0	166.7	173.9	202.8	213.6					
Five years later	117.2	165.2	164.2	174.4	207.7						
Six years later	116.4	166.4	162.5	174.5							
Seven years later	116.7	166.2	161.6								
Eight years later	116.2	166.5									
Nine years later	116.6										
Current estimate of cumulative claims	116.6	166.5	161.6	174.5	207.7	213.6	234.5	283.0	279.6	282.5	2,120.1
Cumulative payments to date	(111.6)	(159.0)	(158.9)	(170.0)	(183.0)	(197.4)	(200.8)	(194.0)	(187.7)	(93.9)	(1,656.4)
Liability recognised for 2003 to 2012 accident years	5.0	7.4	2.7	4.5	24.7	16.2	33.7	89.0	91.9	188.5	463.7
Liability recognised in respect of prior accident years											32.6
Claims handling provision											4.6
Provision as at 31 December 2012											**500.9**

Analysis of claims development – net of reinsurance

Accident year	2003	2004	2005	2006	2007	2008	Restated 2009	Restated 2010	Restated 2011	2012	Total
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Initial estimate of net provision	98.0	131.1	148.0	147.0	136.7	179.3	211.4	243.8	283.4	268.1	
One year later	105.9	129.8	141.4	129.3	151.5	191.2	221.1	260.1	277.4		
Two years later	99.6	129.1	126.1	143.0	151.5	187.5	219.0	269.6			
Three years later	93.5	127.9	129.7	141.6	158.1	181.8	220.0				
Four years later	98.5	122.4	128.0	140.4	147.5	183.8					
Five years later	90.2	122.0	128.8	138.9	147.7						
Six years later	88.3	123.0	126.0	139.0							
Seven years later	89.0	119.7	126.7								
Eight years later	90.4	121.3									
Nine years later	91.9										
Current estimate of cumulative claims	91.9	121.3	126.7	139.0	147.7	183.8	220.0	269.6	277.4	268.1	1,845.5
Cumulative payments to date	(90.3)	(119.4)	(124.9)	(134.9)	(142.8)	(170.3)	(192.3)	(194.3)	(187.7)	(93.9)	(1,450.9)
Liability recognised for 2003 to 2012 accident years	1.6	1.9	1.8	4.1	4.9	13.5	27.7	75.2	89.6	174.2	394.5
Liability recognised in respect of prior accident years											6.3
Claims handling provision											4.6
Provision as at 31 December 2012											**405.4**

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 Risk 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 Investment Committee. Tactical asset allocation meetings are held weekly, and strategic asset allocation meetings quarterly, to discuss investment return and concentration and to agree any changes required.

During 2012 the Company managed its exposure to the equity risk through the use of index futures.

Interest rate risk

The fair value of the Company's portfolio of fixed income securities is inversely correlated to changes in market rates. Thus if interest rates fall the fair value of the portfolio would tend to rise and vice-versa.

The Company monitors interest rate risk by calculating the mean duration of the investment portfolio. The mean duration is an indicator of the sensitivity of the assets to changes in current interest rates. The mean duration of the assets is determined by means of projecting expected cash flows from the assets held. The liabilities are undiscounted and so unaffected in current value by changes in interest rates.

During 2012 the Company managed this risk through an active use of gilt yield hedges, in the form of contracts for differences.

Credit spread risk

In addition to Interest rate risk, described above, a widening of corporate bonds spreads over and above risk-free yields will lead to a fall in the fair value of the Company's portfolio of corporate bonds and vice-versa.

The Company monitors Credit spread risk by regularly reviewing its exposure to corporate bonds by both credit rating and duration. The liabilities are undiscounted and so unaffected in current value by changes in credit spreads.

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

Price risk

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

Currency risk

The Company operates within the UK, however it has 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 our 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 and other minor insurance liabilities. The Company purchases forward foreign exchange contracts to hedge the exposure to foreign exchange movements.

The Company also invests in a number of Collective Investment Schemes, which are predominantly hedge funds. The Investment Managers and Investment Committee apply a stringent process to the selection and subsequent management of these funds. While these funds are not rated their selection for the portfolio is based upon a demonstrable track record of performance. The portfolio is well diversified. Not only are assets spread over a large number of investment managers but also between a number of different strategies. Strategies utilised include macro, long/short equity and relative value. When compared to the overall hedge fund universe the Company's portfolio is considered to be lower return and lower volatility.

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

	Sterling	USD	Euro	Total
As at 31 December 2012	**£000**	**£000**	**£000**	**£000**
Deferred acquisition costs	**26,863**	**-**	**-**	**26,863**
Financial assets at fair value through income				
Shares, other variable yield securities and units in unit trusts	**110,090**	**872**	**-**	**110,962**
Debt and other fixed income securities	**549,769**	**-**	**1,829**	**551,598**
Loans and other receivables	**861**	**-**	**14,599**	**15,460**
Derivative financial instruments	**4,149**	**(3,327)**	**-**	**822**
Receivables				
Receivables arising out of broker insurance operations				
- intermediaries	**30,796**	**-**	**-**	**30,796**
Receivables arising out of reinsurance operations	**96**	**-**	**-**	**96**
Reinsurers' share of insurance contract liabilities	**95,536**	**-**	**-**	**95,536**
Other assets				
Prepayments and accrued income	**10,132**	**-**	**-**	**10,132**
Deferred tax asset	**369**	**-**	**-**	**369**
Current tax asset	**3,434**	**-**	**-**	**3,434**
Cash and cash equivalents	**60,054**	**1,959**	**11,324**	**73,337**
Insurance contracts	**(648,225)**	**-**	**(17,851)**	**(666,076)**
Financial liabilities				
Insurance payables	**784**	**-**	**-**	**784**
Trade and other payables	**13,299**	**-**	**-**	**13,299**
Other financial liabilities	**-**	**-**	**(9,733)**	**(9,733)**
Total	**258,007**	**(496)**	**168**	**257,679**

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

As at 31 December 2011	Sterling £000	USD £000	Euro £000	Total £000
Deferred acquisition costs	28,619	-	-	28,619
Financial assets at fair value through income				
Shares, other variable yield securities and units in unit trusts	604,578	3,257	31	607,866
Debt and other fixed income securities	-	-	2,328	2,328
Loans and other receivables	400	-	-	400
Receivables				
Receivables arising out of broker insurance operations				
- intermediaries	32,895	-	2,684	35,579
Receivables arising out of reinsurance operations	113	-	-	113
Reinsurers' share of insurance contract liabilities	73,058	-	-	73,058
Other assets				
Prepayments and accrued income	1,939	-	-	1,939
Deferred tax asset	4,304	-	-	4,304
Cash and cash equivalents	109,361	-	21,038	130,399
Insurance contracts	(635,623)	-	(13,849)	(649,472)
Financial liabilities				
Insurance payables	1,365			1,365
Trade and other payables	16,737			16,737
Other financial liabilities	-	-	(10,023)	(10,023)
Derivate financial instruments	3,530	(3,477)	-	53
Total	241,276	(220)	2,209	243,265

Sensitivity analysis to market risks

The table below shows the results of sensitivity testing on the Company's pre-tax profit and equity. The sensitivity analysis indicates the effect of changes in market risk factors arising from the impact of the changes in these factors on the Company's financial assets and liabilities.

	Impact on profit before tax 2012 £000	**Impact on equity 2012 £000**	Impact on profit before tax 2011 £000	Impact on equity 2011 £000
Interest rate risk				
+ 50 basis points shift in yield curve	**(34)**	**(26)**	(4,074)	(2,994)
- 50 basis points shift in yield curve	**34**	**26**	4,516	3,319
Credit spread risk				
100 basis points widening in all credit spreads	**(11,327)**	**(8,552)**	(8,232)	(6,051)
100 basis points tightening in all credit spreads	**11,835**	**8,935**	8,952	6,580
Equity price risk (including derivatives)				
20% increase in equity markets	**323**	**244**	3,188	2,343
20% decrease in equity markets	**(323)**	**(244)**	(3,188)	(2,343)

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

Credit 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 counterparty, 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 daily 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. The Company does not require collateral in respect of financial assets. Intermediary debt at 31 December 2012 was £30.8m (2011: £35.6m), 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 Risk Committee and Intermediary Collection Committees and provides against older debts.

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

Credit risk exposure 2012	**AAA £000**	**AA £000**	**A £000**	**BBB £000**	**Not rated £000**	**Total £000**
Debt and other fixed income securities	**200,359**	**51,762**	**173,483**	**125,994**	**-**	**551,598**
Short term bank deposits	**-**	**6,577**	**63,463**	**-**	**-**	**70,040**
Reinsurance assets	**-**	**45,400**	**40,232**	**-**	**9,904**	**95,536**
Total	**200,359**	**103,739**	**277,178**	**125,994**	**9,904**	**717,174**

Credit risk exposure 2011	AAA £000	AA £000	A £000	BBB £000	Not rated £000	Total £000
Debt and other fixed income securities	449	1,296	583	-	-	2,328
Short term bank deposits	-	18,999	108,120	-	-	127,119
Reinsurance assets	1,592	28,130	36,305	-	7,031	73,058
Total	2,041	48,425	145,008	-	7,031	202,505

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

The table below shows the aged analysis of the Company's past due and/or impaired assets:

Age analysis of assets past due/impaired	<31 days	31 to 60 days	61 to 90 days	>90 days	Total past due but not impaired	Past due and impaired	Total
	£000	£000	£000	£000	£000	£000	£000
2012 Insurance receivables	**2,832**	**440**	**122**	**129**	**3,523**	**182**	**3,705**
2011 Insurance receivables	2,468	646	122	410	3,646	317	3,963

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

The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities as they fall due. 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:

		2012			2011	
Maturity profile of financial assets	**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	**152,272**	**510,288**	**662,560**	608,205	1,989	610,194
- Derivative financial instruments	**822**	**-**	**822**	53	-	53
Insurance receivables	**30,892**	**-**	**30,892**	35,692	-	35,692
Loans and other receivables	**15,460**	**-**	**15,460**	400	-	400
Reinsurance assets	**17,473**	**78,063**	**95,536**	17,607	55,451	73,058
Accrued income	**9,701**	**-**	**9,701**	1,939	-	1,939
Cash and cash equivalents	**73,337**	**-**	**73,337**	130,399	-	130,399
Total assets	**299,957**	**588,351**	**888,308**	794,295	57,440	851,735

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 2012	**£000**	**£000**	**£000**	**£000**	**£000**
Insurance contract liabilities	**107,345**	**212,657**	**68,008**	**112,867**	**500,877**
Financial liabilities	**-**	**-**	**-**	**9,733**	**9,733**
Insurance payables	**784**	**-**	**-**	**-**	**784**
Trade and other payables	**13,299**	**-**	**-**	**-**	**13,299**
	121,428	**212,657**	**68,008**	**122,600**	**524,693**

	Within 1 year	1-3 years	3-5 years	Over 5 years	Total
Maturity profile of financial liabilities 2011	£000	£000	£000	£000	£000
Insurance contract liabilities	62,906	229,852	97,617	66,574	456,949
Financial liabilities	-	-	-	10,023	10,023
Insurance payables	1,365	-	-	-	1,365
Trade and other payables	16,737	-	-	-	16,737
	81,008	229,852	97,617	76,597	485,074

Fair value estimation
For financial instruments held at fair value, the fair value measurements by level of the following fair value measurement hierarchy are classified as:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1)
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2)
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

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

The following table presents the Company's assets and liabilities measured at fair value at 31 December 2012:

	2012			
	Level 1	**Level 2**	**Level 3**	**Total**
	£000	**£000**	**£000**	**£000**
Fair value through income				
Shares, other variable yield securities and units in unit trusts	**77,180**	**32,910**	**872**	**110,962**
Debt and other fixed income securities	**57,886**	**493,712**	**-**	**551,598**
Derivatives	**468**	**(9)**	**363**	**822**
	135,534	**526,613**	**1,235**	**663,382**

	2011			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
Fair value through income				
Shares, other variable yield securities and units in unit trusts	16,262	588,367	3,237	607,866
Debt and other fixed income securities	449	1,879	-	2,328
Derivatives	-	53	-	53
	16,711	590,299	3,237	610,247

There have not been any movement of assets between categories in 2012 or 2011.

The fair value of financial instruments included in the Level 1 category 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, 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 assets 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.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3. The financial instruments in level 3 include £1,235,000 (2011: £3,237,000).

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments.
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.
- 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.

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

	Fair value through income £000	**Derivative financial instruments £000**	**Total £000**
Balance at 1 January 2012	3,237	-	3,237
Total gain recorded in comprehensive income	613	363	976
Write off	(871)	-	(871)
Sales	(2,107)	-	(2,107)
Balance at 31 December 2012	**872**	**363**	**1,235**

	Fair value through income £000	Derivative financial instruments £000	Total £000
Balance at 1 January 2011	6,858	-	6,858
Total gain recorded in comprehensive income	(205)	-	(205)
Sales	(3,416)	-	(3,416)
Balance at 31 December 2011	3,237	-	3,237

Sensitivities of level 3 investments
Changing the inputs for the Company’s level 3 assets would not significantly change the fair value.

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 Group Executive Risk Committee, where the risks are reviewed and challenged. The Chief Risk Officer reports on a group basis all strategic risks to the Board Risk Committee.

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

The Company has not identified any significant Group risks.

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.

6. Net premium revenue

	2012 £000	2011 £000
Insurance contracts:		
Premiums written	**331,961**	394,829
Change in unearned premium reserve	**27,324**	3,279
Premium revenue arising from insurance contracts issued	**359,285**	398,108
Reinsurance contracts:		
Premiums payable	**(6,152)**	(5,227)
Change in unearned premium reserve	**90**	17
Premium revenue ceded to reinsurers on insurance contracts issued	**(6,062)**	(5,210)
Net premium revenue	**353,223**	392,898
Motor	**283,565**	318,743
Commercial	**65,171**	70,738
Other	**4,487**	3,417
	353,223	392,898

7. Investment income

	2012 £000	2011 £000
Income from investments and cash and cash equivalents:		
- Interest on loans and receivables	**131**	307
- Interest income	**18,320**	2,048
- Dividend income	**9,176**	18,202
	27,627	20,557

8. Net fair value gains/(losses) on financial assets held at fair value through income

	2012 £000	2011 £000
Gains on financial assets held at fair value through income		
- Debt securities	**8,547**	(1,312)
- Equity securities	**6,768**	(646)
- Derivative financial instruments	**(2,047)**	814
	13,268	(1,144)

Net fair value gains/losses on financial assets held at fair value through income include net realised gains of £3,253,000 (2011: £1,096,000) and net unrealised gains of £10,015,000 (2011: £2,240,000 losses).

9. Other income

	2012 £000	2011 £000
Commissions receivable	**2,872**	4,496
Deposit interest receivable	**-**	3
	2,872	4,499

10. Insurance claims and loss adjustment expenses

	2012 £000	2011 £000
Gross insurance claims		
Claims paid during the year	**251,157**	250,936
Movement in claims liabilities	**43,928**	63,971
Claims management costs	**12,866**	13,201
	307,951	328,108
Reinsurers share of gross insurance claims		
Claims paid during the year	**(7,475)**	(6,748)
Movement in reinsurers share on claims liabilities	**(22,388)**	(14,787)
	(29,863)	(21,535)
Net insurance claims	**278,088**	306,573

Included within claims incurred is an increase of £26.3m in respect of motor insurance business (2011: £19.2m increase), 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.

11. Finance costs

	2012 £000	2011 £000
Interest payable	**484**	496
	484	496

12. Other operating and administrative expenses

	2012 £000	2011 £000
Investment management expenses and charges	**1,052**	976
Acquisition expenses	**53,346**	58,550
Movement in deferred acquisition expenses	**1,757**	(754)
Administrative expenses	**32,396**	24,022
Auditors' remuneration	**150**	125
Impairment of insurance receivables	**182**	317
	88,883	83,236

13. Auditors' remuneration

	2012 £000	2011 £000
Audit of company	**140**	115
Audit related assurance services	**10**	10
	150	125

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

14. Directors' emoluments

The Directors of the Company are remunerated by LVFS or LVIM.

The details of directors' emoluments below include the total emoluments of those directors who have a group role, 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 Group.

The aggregate amount of Directors' emoluments was as follows:

	2012 £000	2011 £000
a) Aggregate emoluments	**7,026**	6,110

b) There were £44,634 of contributions to the defined contribution pension scheme (2011: £69,867).

c) Emoluments of the Directors were as follows:

	Salaries £000	Bonus £000	Deferred bonus * £000	Other benefits £000	Long term incentive plan £000	Total 2012 £000	Total 2011 £000
Highest paid Director	**505**	**427**	**132**	**127**	**1,431**	**2,622**	2,178
All Directors	**2,684**	**1,649**	**184**	**229**	**2,280**	**7,026**	6,110

* Deferred bonus represents the amount of the 2012 performance bonus payable over the next three years in line with the new "Variable pay deferral" scheme implemented by the LVFS remuneration committee in 2012.

Other benefits include contributions to funded unapproved retirement benefit schemes, life assurance, company car allowances, medical, relocation and other benefits in kind or their equivalent monetary value.

LVFS has made no contributions to personal pension arrangements during 2012 or 2011.

d) Pension arrangements
P M Bunker, P A Horton, S V Castle, J B O'Roarke, S R Haynes and S C A Fernandes are members of the LV= Employee Pension Scheme, which is a defined benefit scheme administered at group level.

LVFS makes contributions to the LV= Employee Pension Scheme of 17.8% of pensionable salaries (2011: 17.1% of pensionable salaries), subject to annual allowance limits, in respect of all permanent staff, including executive directors. This included amounts on behalf of executive directors of £121,171 (2011: £193,078) on the defined benefit scheme.

M J Rogers is a member of the staff pension scheme for life assurance only.

Details on the LV= Employee Pension Scheme are disclosed with the financial statements of LVFS.

Accrued pension at end of period	2012 £000	2011 £000
All Directors	**194**	193

15. Income tax expense

a) Current year tax expense

	2012 £000	2011 £000
Current year tax expense		
Corporation tax	**3,148**	-
Adjustment to current tax in respect of prior years	**-**	325
Total current tax	**3,148**	325
Deferred tax expense		
Deferred tax credit	**3,940**	7,047
Adjustment to deferred tax in respect of prior years	**(5)**	(795)
Total deferred tax	**3,935**	6,252
Total income tax expense	**7,083**	6,577

b) Reconciliation of tax expense

The tax assessed for the year is lower than the standard rate of corporation tax in the UK (24.5%). The differences are explained below:

	2012 £000	2011 £000
Profit before tax	**29,535**	26,505
Profit multiplied by standard rate of corporation tax in the UK of 24.5% (2011: 26.5%)	**7,236**	7,023
Effects of:		
Impact of change in UK tax rate on deferred tax	**148**	525
Income not subject to corporation tax	**(296)**	(501)
Adjustment to current tax in respect of prior years	**-**	325
Adjustment to deferred tax in respect of prior years	**(5)**	(795)
Total income tax expense for the year	**7,083**	6,577

The standard rate of corporation tax in the UK changed from 26% to 24% with effect from 1 April 2012. Accordingly, the profits for this accounting period are taxed at an effective rate of 24.5%.

16. Deferred acquisition costs

	2012	2011
	£000	£000
At 1 January	**28,619**	27,866
Acquisition expenses deferred	**53,346**	58,550
Amortisation	**(55,102)**	(57,797)
At 31 December	**26,863**	28,619

17. Financial assets

	2012	2011
	£000	£000
Fair value through income		
Shares, other variable yield securities and units in unit trusts	**110,962**	607,866
Debt and other fixed income securities	**551,598**	2,328
	662,560	610,194

18. 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:

	2012			2011		
	Contract/ notional amount	**Fair value - asset**	**Fair value - liability**	Contract/ notional amount	Fair value - asset	Fair value - liability
	£000	**£000**	**£000**	£000	£000	£000
Forward exchange contracts	**3,318**	**-**	**(9)**	3,472	-	(5)
Futures (FTSE 100)	**30,235**	**468**	**-**	1,382	58	-
Contracts for differences (gilt hedge)	**503,100**	**363**	**-**	-	-	-
	536,653	**831**	**(9)**	4,854	58	(5)

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, a significant proportion of the Company's asset portfolio was hedged against the stock market and gilt yield movements.

19. Loans and other receivables

	2012	2011
	£000	£000
Deposits with credit institutions	**14,599**	-
Other receivables	**861**	400
	15,460	400

20. Insurance receivables

	2012	2011
	£000	£000
Receivables arising from insurance and reinsurance contracts:		
- Due from agents, brokers and intermediaries	**30,796**	35,579
- Due from reinsurers	**96**	113
	30,892	35,692

As at 31 December 2012 overdue insurance receivables arising from insurance contracts were provided at £182,000 (2011: £317,000).

21. Reinsurance assets

	2012	2011
	£000	£000
Reinsurers' share of provision for unearned premiums	**107**	17
Reinsurers' share of claims outstanding	**95,429**	73,041
	95,536	73,058

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

22. Prepayments and accrued income

	2012	2011
	£000	£000
Accrued interest	**9,701**	1,939
Prepayments	**431**	-
	10,132	1,939

Accrued interest includes £9,397,000 (2011: £1,416,000) of interest relating to fixed income securities.

23. Deferred tax asset

	2012 £000	2011 £000
At 1 January	**4,304**	10,556
Current year charge	**(3,935)**	(6,252)
At 31 December	**369**	4,304

Analysis of deferred taxation temporary differences:

	2012 £000	2011 £000
Advanced capital allowances	**369**	492
Taxable losses carried forward	**-**	3,812
	369	4,304

The analysis of the deferred tax balance is as follows:

	2012 £000	2011 £000
Deferred tax asset expected to be recovered after more than 12 months	**302**	393
Deferred tax asset expected to be recovered within 12 months	**67**	3,912
Net deferred tax asset	**369**	4,304

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 Statement of financial position as at 31 December 2012.

Deferred tax balances have been measured taking into account the change in the rate of UK corporation tax from 24% to 23%. This change was substantively enacted on 3 July 2012 and will be effective from 1 April 2013.

In addition to the changes in rates of Corporation Tax disclosed above, a number of further changes to the UK Corporation Tax system were announced in the 2013 draft Finance Bill. Further reductions to the main rate are proposed to reduce the rate by 2% to 21% by 1 April 2014. These further changes had not been substantively enacted at the Statement of financial position date and, therefore, are not included in these financial statements.

24. Current tax

	2012 £000	2011 £000
At 1 January	**-**	-
Amounts recorded in the Statement of comprehensive income	**(3,148)**	(325)
Income tax paid	**6,582**	-
Relief for tax losses brought forward	**-**	325
At 31 December	**3,434**	-

25. Cash and cash equivalents

	2012 £000	2011 £000
Bank balances	**3,297**	3,280
Short term bank deposits	**70,040**	127,119
Cash and cash equivalents	**73,337**	130,399

26. Insurance contract liabilities

a) Analysis of insurance contract liabilities

	2012			2011		
	Gross £000	**Reinsurance £000**	**Net £000**	Gross £000	Reinsurance £000	Net £000
General insurance claims liabilities	**500,877**	**(95,429)**	**405,448**	456,949	(73,041)	383,908
General insurance unearned premiums	**165,199**	**(107)**	**165,092**	192,523	(17)	192,506
	666,076	**(95,536)**	**570,540**	649,472	(73,058)	576,414

b) Movement in general insurance claims liabilities

	2012			2011		
	Gross £000	**Reinsurance £000**	**Net £000**	Gross £000	Reinsurance £000	Net £000
OCR	**459,897**	**(46,999)**	**412,898**	428,263	(51,467)	376,796
IBNR	**(2,948)**	**(26,042)**	**(28,990)**	(35,285)	(6,787)	(42,072)
Balance at 1 January	**456,949**	**(73,041)**	**383,908**	392,978	(58,254)	334,724
Movement in claims incurred in prior accident years	**17,276**	**(15,527)**	**1,749**	17,761	(18,345)	(584)
Claims incurred in the current accident year	**277,809**	**(14,336)**	**263,473**	297,146	(3,190)	293,956
Claims paid during the year	**(251,157)**	**7,475**	**(243,682)**	(250,936)	6,748	(244,188)
	43,928	**(22,388)**	**21,540**	63,971	(14,787)	49,184
Balance at 31 December	**500,877**	**(95,429)**	**405,448**	456,949	(73,041)	383,908
OCR	**477,060**	**(47,622)**	**429,438**	459,897	(46,999)	412,898
IBNR	**23,817**	**(47,807)**	**(23,990)**	(2,948)	(26,042)	(28,990)
Balance at 31 December	**500,877**	**(95,429)**	**405,448**	456,949	(73,041)	383,908

c) Movement in general insurance unearned premiums

	2012			2011		
	Gross £000	**Reinsurance £000**	**Net £000**	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	**192,523**	**(17)**	**192,506**	195,802	-	195,802
Premiums written in the year	**331,961**	**(6,152)**	**325,809**	394,829	(5,227)	389,602
Premiums earned during the year	**(359,285)**	**6,062**	**(353,223)**	(398,108)	5,210	(392,898)
Balance at 31 December	**165,199**	**(107)**	**165,092**	192,523	(17)	192,506

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 under-stated 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 under-statement 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. Other financial liabilities

	2012	2011
	£000	£000
Subordinated note	**9,733**	10,023
	9,733	10,023

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

28. Insurance payables

	2012	2011
	£000	£000
Due to brokers and intermediaries	**-**	30
Due to reinsurers	**784**	1,335
	784	1,365

29. Trade and other payables

	2012 £000	2011 £000
Amounts due to group undertakings	**3,951**	5,589
Trade payables	**399**	576
Other taxes and social security costs	**4,819**	5,378
Other payables	**97**	40
Accruals and deferred income	**4,033**	5,154
	13,299	16,737

30. Share capital

	2012 £000	2011 £000
Ordinary shares, allotted and fully paid		
75,000,000 (2011: 75,000,000) ordinary shares of £1 each	**75,000**	75,000

31. Capital reserve

	2012 £000	2011 £000
Balance at 1 January	**150,000**	150,000
Balance at 31 December	**150,000**	150,000

These amounts are distributable in future periods, subject to the provisions of the Companies Act 2006.

32. Retained earnings/(accumulated losses)

	2012 £000	2011 £000
Balance at 1 January	**(17,939)**	(37,867)
Profit for the year	**22,452**	19,928
Balance at 31 December	**4,513**	(17,939)

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

	2012 £000	Restated (see note 2) 2011 £000
Profit before tax	**29,535**	26,505
Investment income	**(27,627)**	(20,557)
Finance costs	**484**	496
(Gains)/losses on financial assets recorded in the statement of comprehensive income	**(13,268)**	1,144
Exchange gains on financial assets recorded in the statement of comprehensive income	**(290)**	(259)
Net purchases of investments at fair value through income	**(37,051)**	(11,375)
Net (purchases)/sales of derivative financial instruments	**(2,816)**	638
Non cash items		
Expenses deferred during the year	**1,756**	(753)
Changes in working capital		
(Increase)/decrease in loans and other receivables	**(15,060)**	1,785
Increase in reinsurance assets	**(22,478)**	(14,804)
Decrease in insurance receivables	**4,800**	7,927
(Increase)/decrease in other prepayments and accrued income	**(431)**	419
Increase in insurance contract liabilities	**16,604**	60,692
(Decrease)/increase in insurance payables	**(581)**	748
(Decrease)/increase in trade and other payables	**(3,438)**	6,419
Cash (used in)/generated from operating activities	**(69,861)**	59,025

34. Related party transactions

The Company did not directly enter into transactions with key management personnel, all transactions have been settled by LVFS instead. 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:

The following transactions have taken place between the Company and other Group companies:

	2012 **£000**	2011 £000
Short-term employee benefits	**4,746**	4,152
Post employee benefits	**166**	263
Other long-term benefits	**2,280**	1,838
Termination benefits	**-**	120
	7,192	6,373

	2012 **£000**	2011 £000
Management charge from group undertakings (LV Insurance Management Limited)	**(44,387)**	(33,575)
	(44,387)	(33,575)

Balances outstanding between the Company and other Group companies:

	2012 **£000**	2011 £000
Other balances (payable)/receivable by the Company (LVFS)	**(3,951)**	(5,589)
	(3,951)	(5,589)

35. 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/aboutus/report