COMPANY REGISTRATION NO: 0003730662

HIGHWAY
INSURANCE COMPANY LIMITED

REPORT AND
FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

C O N T E N T S

DIRECTORS, OFFICERS AND REGISTERED OFFICE

Directors

P M Bunker		
S V Castle		
R C Dix	Resigned 31 January 2011	
S Haynes	Appointed 25 October 2011	
P A Horton		
P W Moore		
M S Newton	Resigned 31 January 2011	
J B O'Roarke		
M J Rogers		
R A Warner	Appointed 28 February 2011	
J M Webber	Appointed 16 March 2011	Resigned 12 August 2011

Company secretary
P B Cassidy

Registered office
Frizzell House
County Gates
Bournemouth
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 2011.

1. Results and dividends

The profit for the year was £19,928,000 (2010: £13,234,000) as set out on page 9. The Directors proposed and paid no dividends in the current year (2010: £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 2011 results for the Company show a profit after taxation of £19,928,000. Whilst good price increases have been achieved at individual product level in 2011, underlying business volume growth has been moderate as the company has concentrated upon improving margins rather than achieving growth. The benefits of these actions can be seen in the 2011 loss ratio improvement and will continue to be seen in future years.

The following factors have had a material effect on the result for the year (see also the Key Performance Indicators on page 5):

1. Premium income growth: The Company has seen premium income growth of 6% in 2011. UK motor market conditions prevalent in 2011 have allowed the Company to implement good price increases whilst at the same time maintaining business volumes.

2. Investment returns: Overall investment returns in 2011 have been relatively weak. The financial markets in 2011 have been volatile and have been impacted by low confidence levels. Uncertainty around the outlook for the UK economy, the impact of the Eurozone difficulties and wider global considerations, have all contributed to 2011 being a very difficult year for the investment markets. The Company has benefited from having a spread of investment risk across a broad range of investment classes and from proactive asset allocation during the year. Funds under management have also increased significantly 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. Notwithstanding this, the Company still delivered a low expense ratio of 20% in 2011, as a result of good cost management processes and economies of scale due to the growth of the business in 2011.

4. Underwriting and Claims: During 2011 the Company has continued to develop its products and improve pricing and underwriting activities. In addition significant work has been done in the claims area aimed at improving the efficiency of claims processes and reducing claims leakage. In our motor business the benefits of a reduction in the frequency of car accidents were offset by a further increase in personal injury ('PI') claims and attempted fraud. We have adopted a strong 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. As a result in 2011 the Company has delivered a good overall loss ratio.

The management views 2011 as a year where it has been able to demonstrate that it can deliver sustainable profits even as it continues to grow.

(b) Business environment
At the beginning of 2011 UK insurance market prices were expected to move upwards in the early part of the year but with increasing price competition building up as the year progressed. In relation to the motor market, which is the Company's major line of business, these expectations have overall been exceeded in 2011 with the market supporting strong price increases. Most companies are currently continuing to prioritise margin improvement over market share. Early indications in 2012 are that this may continue (particularly given the uncertainties surrounding investment returns and the cost of capital), however as 2012 develops it is expected that ultimately more competition will be seen returning to the market as market underwriting results improve. In addition the continued and increasing impact of the internet in general and aggregators (such as www.comparethemarket.com) in particular will ensure that competitive market pricing returns sooner rather than later.

On 1 March 2011, the European Court of Justice issued judgement that, with effect from 21 December 2012, gender may no longer be used as a differentiating factor in the pricing of insurance contracts. Whilst this does not have any financial reporting impact for 2011, it will affect the pricing of motor insurance contracts in future.

(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 become 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 Company will operate best-practice processes and technology in order to provide superior customer service through a people-focused and empowered culture. LVGIG will ultimately deliver attractive and consistent returns to the members of Liverpool Victoria Friendly Society ('LVFS').

The Company will make its contribution to the LVGIG strategic objectives through leveraging 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 supporting price increases as most companies are aiming for underwriting margin rather than market share – the main driver of this being to make up for past losses, increasing claims inflation, investment return uncertainties and tight capital. It is anticipated that whilst the market may well see increasing price competition as insurance companies return to acceptable underwriting and investment returns, the timing and extent of this increasing price competition are not easy to predict.

UK Insurance Market – Claims: The UK motor market continues to see increased PI claims driven by referral fee processes and claims management companies. Whilst referral fees will at some point be banned, this is not now likely to occur in 2012 and therefore we anticipate that increased PI claims activity will continue during 2012. 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 becoming more common, again this trend is likely to continue into the future. Management is monitoring and managing this area very closely.

Economic Environment: The current depressed financial and wider economic environment has meant that expectations of investment returns over the next few years are very uncertain. The Company will also need to pay particular attention to credit risk and increased claims leakage through fraud. Capital management will be a material consideration in the future.

Regulatory: There are a number of legal and regulatory developments which are likely to impact the UK market in 2012. These include the current Office of Fair Trading ('OFT') review of general insurance, the banning of referral fees and the implementation of the gender directive. Finally work continues on preparing for the Solvency II capital regime. Management is continually monitoring these developments and taking appropriate action to ensure that the Company is well prepared.

Business Change: The Company is still going through a number of material transformation processes (including managing its recent growth and a full review of its systems and telephony strategy) as it positions itself 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 increasing influence of the internet and aggregators has changed and continues to change the business operating environment. Companies need to be able to respond very quickly to the changing circumstances.

Exceptional Weather Events: Exceptional catastrophic 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 protections.

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 continue to increase its premium income in 2012 and 2013. This growth will come in part from anticipated price increases but also from increased volumes 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 balance sheet events
There have been no events of significance affecting the Company since the balance sheet date.

(g) Key performance indicators
The Board sets key performance indicators ('KPIs') and targets for its main operating entities, which it monitors on a regular basis throughout the year. These KPIs change from time to time as objectives and priorities change. During 2011, 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	2011	2010	Comments
Premiums written	£395m	£373m	Premiums written is showing year on year growth of 6% due primarily to price increases achieved during 2011. Underlying business volumes grew by less than 1%. The main objective of the Company during 2011 was to improve underwriting margins rather than to grow materially.
Loss ratio	78.0%	85.6%	The Company delivered a significantly improved loss ratio in 2011 down by 7.6% compared to 2010. This is as a result of the price increases achieved during 2011 and 2010 earning through. A reported loss ratio of 78% for 2011 will, we feel, compares well to our competitors in the market.
Expense ratio	20.0%	18.1%	A net expense ratio (including other income) of 20% has been reported for 2011. Whilst this is a good result, which will compare well with our market peers, it is higher than the expense ratio reported in 2010 (18.1%). However this apparent adverse movement is primarily due to the fact that both other income and expenses in 2010 benefited from a number of one-off favourable items which enhanced the reported expense ratio for the year.
Combined ratio	98.0%	103.6%	The combined ratio of 98% has improved materially (by 5.6%) compared to 2010. This is wholly due to the improved loss ratio reported. The long term objective is to maintain the combined ratio at about this level in future years.
Investment return	£19m	£31m	Total investment return includes: 1. Investment income and 2. Net fair value gains/losses on financial assets Total investment return is significantly lower than in 2010 (down £12m, 39%). This is representative of the depressed investment market conditions in 2011. In terms of average returns 2011 saw a return of 2.8% whereas 2010 reported 5.5% return. The lower average returns were mitigated to an extent by the increased funds under management in 2011 (up 14%).
Net assets	£207m	£187m	Net assets have increased during 2011 to £207m reflecting the post tax profits made by the Company in 2011.

4. Directors and their interests
The present members of the Board and the members who served during the year are listed on page 1.

5. Parent company
The Company is a wholly owned subsidiary of Highway Insurance Group Limited (formerly Highway Insurance Group Plc) ('HIG'). The ultimate parent company is LVFS, an incorporated Friendly Society registered under the Friendly Societies Act 1992.

6. Employees
The Company did not directly employ any staff during 2011. 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 2011 (2010: £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 auditor is 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 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.

By order of the board

P B Cassidy
Company Secretary

24 February 2012

We have audited the financial statements of Highway Insurance Company Limited for the year ended 31 December 2011 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 2011 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

24 February 2012

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2011

	Note	2011 £000	2010 £000
Insurance contract premium revenue	6	**398,108**	316,273
Insurance contract premium ceded to reinsurers	6	**(5,210)**	(5,613)
Net premium revenue		**392,898**	310,660
Investment income	7	**20,557**	16,016
Net fair value (losses)/gains on financial assets at fair value through income	8	**(1,144)**	14,833
Other income	9	**4,499**	4,253
Total income		**416,810**	345,762
Insurance claims and loss adjustment expenses	10	**(328,108)**	(259,698)
Insurance claims and loss adjustment expenses recoverable from reinsurers	10	**21,535**	(6,191)
Net insurance claims		**(306,573)**	(265,889)
Finance costs	11	**(496)**	(465)
Other operating and administrative expenses	12	**(83,236)**	(60,362)
Total claims and expenses		**(390,305)**	(326,716)
Profit before tax		**26,505**	19,046
Income tax expense	15	**(6,577)**	(5,812)
Profit for the year		**19,928**	13,234
Total comprehensive income for the year		**19,928**	13,234

All balances relate to continuing business.
The notes on pages 13 to 44 are an integral part of the financial statements.

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2011

		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	31	-	19,928	-	19,928
Balance at 31 December 2011		**75,000**	**(17,939)**	**150,000**	**207,061**

		Attributable to equity holder of the Company			
		Share capital	Accumulated losses	Capital Reserve	Total
	Note	£000	£000	£000	£000
Balance at 1 January 2010		75,000	(51,101)	110,000	133,899
Capital contributions	30	-	-	40,000	40,000
Profit for the year	31	-	13,234	-	13,234
Balance at 31 December 2010		75,000	(37,867)	150,000	187,133

The notes on pages 13 to 44 are an integral part of the financial statements.

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2011

	Note	2011 £000	2010 £000
Assets			
Deferred acquisition costs	16	**28,619**	27,866
Financial assets			
- Fair value through income	17	**610,194**	600,780
- Loans and other receivables	17	**400**	2,185
- Derivative financial instruments	25	**53**	-
Insurance receivables	18	**35,692**	43,619
Reinsurance assets	19	**73,058**	58,254
Prepayments and accrued income	20	**1,939**	3,884
Deferred tax asset	21	**4,304**	10,556
Cash and cash equivalents	23	**130,399**	50,109
Total assets		**884,658**	797,253
Liabilities			
Insurance contract liabilities	24	**649,472**	588,780
Financial liabilities			
- Derivative financial instruments	25	**-**	123
- Other financial liabilities	26	**10,023**	10,282
Insurance payables	27	**1,365**	617
Trade and other payables	28	**16,737**	10,318
Total liabilities		**677,597**	610,120
Equity			
Share capital	29	**75,000**	75,000
Capital reserve	30	**150,000**	150,000
Accumulated losses	31	**(17,939)**	(37,867)
Total equity		**207,061**	187,133
Total liabilities and equity		**884,658**	797,253

The notes on pages 13 to 44 are an integral part of the financial statements.

These financial statements were approved by the Board of Directors on 24 February 2012.

Signed on behalf of the Board of Directors

P.W. Moore

P W Moore
Director

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2011

	Note	**2011 £000**	2010 £000
Cash and cash equivalents at 1 January	23	**50,109**	89,114
Cash flows arising from:			
Operating activities			
Cash generated from/(used in) operating activities	32	**80,786**	(84,588)
Finance cost paid		**(496)**	(465)
Tax relief		**-**	1,271
Income tax (paid)/refund received	22	**-**	4,777
Net cash flows generated from/(used in) operating activities		**80,290**	(79,005)
Financing activities			
Proceeds from capital contribution	30	**-**	40,000
Net cash flows generated from financing activities		**-**	40,000
Net increase/(decrease) in cash and cash equivalents		**80,290**	(39,005)
Cash and cash equivalents at 31 December	23	**130,399**	50,109

The notes on pages 13 to 44 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 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.

Comparative numbers within notes 7, 8, 23 and 28 have been restated to align with Liverpool Victoria Friendly Society Limited.

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 reinsurance 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.

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 on deposits and interest on loan advances to customers. Dividends are included on an ex-dividend basis. Interest on deposits and 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 original cost.

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 subsequent accounting periods, are deferred and recognised as an asset to the extent that they are recoverable out of margins in future matching revenues. In respect of insurance contracts, acquisition costs comprise of all 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 a provision for losses arising from liability adequacy tests. Any DAC written off as a result of this test cannot subsequently be reinstated.

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
Financial assets at fair value through income has two sub categories:
- financial assets held for trading; and
- those designated at fair value through income at inception.

All investments of the Company classified as fair value are designated as fair value through income at inception. This is in accordance with the Company's documented investment strategy and consistent with investment risk being assessed on a portfolio basis. 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.

Trade and other receivables
Trade 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. Trade 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

(a) Financial assets carried at amortised cost.

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) it becoming probable that the issuer or debtor will enter bankruptcy or other financial reorganisation;

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.

(b) Non-Financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount.

The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

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 and reinsurers.

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) Standards, amendments to published standards and interpretations effective on or after 1 January 2011

The following amendments to published standards are mandatory for the Company's accounting periods beginning on or after 1 January 2011:

In May 2010 the IASB issued its annual amendments to IFRSs. The IASB uses the annual improvements process to make necessary, but non-urgent, amendments to IFRSs that will not be included as part of major projects.
This set of amendments includes changes to six standards and one IFRIC and is based on the exposure draft issued in August 2009 with an additional change to IFRS 1, 'First-time adoption of International Accounting Standards', which was exposed as part of the 'Rate regulated activities' proposals issued in July 2009.

These amendments have had only a minor impact on some of the disclosures given in the financial statements.

(ii) Standards, amendments to published standards and interpretations early adopted by the Company

In 2011, the Company did not early adopt any new, revised or amended standards.

(iii) Standards and interpretations effective in 2011 but not relevant to the Company's operations

IAS 24 (revised) 'Related party disclosures'.
'Classification of rights issues' (amendment to IAS 32).
Amendment to IFRS 1 'First time adoption on financial instrument disclosures'.
Amendment to IFRIC 14 'Prepayments of a minimum funding requirement'.
IFRIC 19 'Extinguishing financial liabilities with equity instruments'.
IFRIC 16 'Hedges of a net investment in a foreign operation'.

(iv) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Company

The following standards and amendments to existing standards have been published and are mandatory for the Company's accounting periods beginning on or after 1 January 2012 or later periods, and the Company has not early adopted them:

Amendment to IFRS 7, Financial Instruments: Disclosures on derecognition, issued in October 2010. The amendment applies to annual periods beginning on or after 1 July 2011. Earlier application is permitted. These amendments are as part the IASB's comprehensive review of the off statement of financial position activities. The amendments will promote transparency in the reporting of transfer transactions and improve users' understanding of the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitisation of financial asset. The change is not expected to have a material impact on the Company's financial statements.

IAS 19 (revised 2011) 'Employee benefits', issued in June 2011. This amendment makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The changes will affect most entities that apply IAS 19. They could significantly change a number of performance indicators and might also significantly increase the volume of disclosures.
The amendment applies to annual periods beginning on or after 1 January 2013. The change is not expected to have an impact on the Company's financial statements.
Amendment to IAS 1 'Financial statement presentation, on other comprehensive income (OCI)', issued in June 2011. This amendment changes the disclosure of items presented in other comprehensive income (OCI) in the statement of comprehensive income. The IASB originally proposed that all entities should present profit or loss and OCI together in a single statement of comprehensive income. The proposal has been withdrawn and IAS 1 will still permit profit or loss and OCI to be presented in either a single statement or in two consecutive statements. The Company is yet to assess the full impact of amendments and intends to adopt the amended IAS 1 no later than the accounting period beginning on or after 1 January 2013.
Amendment to IFRS 1 'First time adoption' on hyperinflation and fixed dates, issued in December 2010. These amendments are based on two exposure drafts. The first amendment replaces references to a fixed date of '1 January 2004' with 'the date of transition to IFRSs', thus eliminating the need for companies adopting IFRSs for the first time to restate derecognition transactions that occurred before the date of transition to IFRSs. The second amendment provides guidance on how an entity should resume presenting financial statements in accordance with IFRSs after a period when the entity was unable to comply with IFRSs because its functional currency was subject to severe hyperinflation. The amendments apply to annual periods beginning on or after 1 July 2011 and are not expected to have any impact on the Company's financial statements.

Amendment to IAS 12 'Income taxes' on deferred tax, issued in December 2010. Currently IAS 12, 'Income taxes', requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale. It can be difficult and subjective to assess whether recovery will be through use or through sale when the asset is measured using the fair value model in IAS 40 Investment Property. Hence this amendment introduces an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value. As a result of the amendments, SIC 21, 'Income taxes- recovery of revalued non-depreciable assets', would no longer apply to investment properties carried at fair value. The amendments also incorporate into IAS 12 the remaining guidance previously contained in SIC 21, which is accordingly withdrawn. The amendments apply to annual periods beginning on or after 1 January 2012 and are not expected to have any impact on the Company's financial statements.

IFRS 9 'Financial Instruments' on 'classification and measurement' of financial assets, issued in November 2009. This is the first part of a new standard on classification and measurement of financial assets that will replace IAS 39. IFRS 9 has two measurement categories: amortised cost and fair value. All equity instruments are measured at fair value. A debt instrument is at amortised cost only if the entity is holding it to collect contractual cash flows and the cash flows represent principal and interest. Otherwise it is at fair value through profit or loss.

IFRS 9 'Financial Instruments' on 'classification and measurement' of financial liabilities, issued in October 2010. These are further additions to IFRS 9 dealing with financial liabilities. The additions, which are part of the IASB's plan to replace IAS 39, retain most of the IAS 39 requirements. These include amortised cost accounting for most financial liabilities, with bifurcation of embedded derivatives. The main change in the additions 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. This change will mainly affect financial institutions.

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 2013.

IFRS 10 'Consolidated financial statements', issued in May 2011. This standard builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements. The standard provides additional guidance to assist in determining control where this is difficult to assess. This new standard might impact the entities that a group consolidates as its subsidiaries. The Company is yet to assess IFRS 10's full impact and intends to adopt IFRS 10 no later than the accounting period beginning on or after 1 January 2013.

IFRS 11 'Joint arrangements', issued in May 2011. This standard provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form. There are two types of joint arrangements: joint operations and joint ventures. Joint operations arise where a joint operator has rights to the assets and obligations relating to the arrangement and hence accounts for its interest in assets, liabilities, revenue and expenses. Joint ventures arise where the joint operator has rights to the net assets of the arrangement and hence equity accounts for its interest. Proportional consolidation of joint ventures is no longer allowed. The Company is yet to assess IFRS 11's full impact and intends to adopt IFRS 11 no later than the accounting period beginning on or after 1 January 2013.

IFRS 12 'Disclosure of interests in other entities' This standard includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off statement of financial position vehicles. The Company is yet to assess IFRS 12's full impact and intends to adopt IFRS 12 no later than the accounting period beginning on or after 1 January 2013.

IFRS 13 'Fair value measurement', issued in May 2011. This standard 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. The Company is yet to assess IFRS 13's full impact and intends to adopt IFRS 13 no later than the accounting period beginning on or after 1 January 2013.

IAS 27 (revised) 'Separate financial statements', issued in May 2011. This standard includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10. The Company is yet to assess the full impact of the amendments and intends to adopt the amended IAS 27 no later than the accounting period beginning on or after 1 January 2013.

IAS 28 (revised) 'Investments in associates and joint ventures', issued in May 2011. This standard includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS

11. The Company is yet to assess the full impact of the amendments and intends to adopt the amended IAS 28 no later than the accounting period beginning on or after 1 January 2013.

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 view of recent market dislocation, the markets for some assets have become less liquid and therefore the valuations are less certain than in previous years. 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. In particular, household insurance policies are exposed to claims for subsidence and motor insurance policies are exposed to claims for bodily injury.

Estimation of the ultimate cost of subsidence claims is complex. It is difficult to know the incurred date of a subsidence claim; indeed the claim may have been incurred over a period of time rather than on one particular day. Because of this, subsidence figures cannot reliably be split by accident year. Significant factors that affect the trends that influence the subsidence process stem mainly from the impact of the much drier weather conditions, tree root activity, the upturn in the housing market and the additional extensive press publicity generating anxiety and overreactions to minor cracking. Due to this uncertainty, it is not possible to determine the future development of subsidence claims with the same degree of reliability as with other types of claim.

Estimation of the ultimate 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.

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 an efficient capital structure from a combination of equity, 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 developed;
(iii) To give confidence to consumers 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 quantum 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 of any significance: 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.

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

The Company had capital available of £207,061,000 (2010: £187,133,000), being net assets available to the Company.

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.

Highway 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 Group has entered into excess of loss reinsurance contracts which reduce its exposure to large claims. The reinsurance retention is £5.0m per claim (2010: £5.0m per claim).

The Company has entered into 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 (GI) contract liabilities by type of contract:

	2011			2010		
	Gross	**Reinsurance**	**Net**	Gross	Reinsurance	Net
	£000	**£000**	**£000**	£000	£000	£000
Motor	**379,354**	**(67,920)**	**311,434**	392,798	(58,254)	334,544
Commercial	**77,557**	**(5,121)**	**72,436**			
Household	**38**	**-**	**38**	180	-	180
	456,949	**(73,041)**	**383,908**	392,978	(58,254)	334,724

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. 'PPOs', Ministry of Justice reform, 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 the exposure to 'PPOs' as the key area of uncertainty relating to the claims provision as at 31 December 2011. 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 £15m from the position shown above.

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. Again, whilst the claims provision allows for an expected level of late reported / reserved large claims, a higher number observed will lead to a deterioration in reserves. As an example, reserves would increase by £5m, assuming one large claim (exceeding our reinsurance retention of £5m) is incurred above the level expected.

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 strong reserves in order to protect against adverse future claims experience and developments. As claims develop and the ultimate costs become more certain, adverse claims experiences are eliminated which results in a release from earlier accident years.

Analysis of claims development – gross of reinsurance

Accident year	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**Total**
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Initial estimate of gross provision	53,236	135,592	186,443	185,332	184,529	186,732	208,387	225,373	253,170	297,359	
One year later	59,370	142,293	179,817	191,271	179,987	196,802	243,594	229,505	274,387		
Two years later	55,748	131,910	179,586	179,300	179,697	198,483	219,979	229,157			
Three years later	51,812	121,188	169,009	171,572	179,460	200,687	211,961				
Four years later	49,379	116,269	167,018	166,653	173,910	202,842					
Five years later	51,737	117,182	165,215	164,192	174,388						
Six years later	52,065	116,385	166,407	162,464							
Seven years later	53,023	116,714	166,245								
Eight years later	51,051	116,200									
Nine years later	50,587										
Current estimate of cumulative claims	50,587	116,200	166,245	162,464	174,388	202,842	211,961	229,157	274,387	297,359	1,885,590
Cumulative payments to date	(50,449)	(111,840)	(158,945)	(158,521)	(168,041)	(175,683)	(188,892)	(175,341)	(163,180)	(107,385)	(1,458,277)
Liability recognised for 2002 to 2011 accident years	138	4,360	7,300	3,943	6,347	27,159	23,069	53,816	111,207	189,974	427,313
Liability recognised in respect of prior accident years											20,419
Claims handling provision											9,217
Provision as at 31 December 2011											**456,949**

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

Analysis of claims development – net of reinsurance

Accident year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Initial estimate of net provision	51,186	97,983	131,137	147,968	147,013	136,698	179,310	205,361	249,269	294,163	
One year later	53,267	105,894	129,780	141,447	129,289	151,532	191,179	207,205	259,927		
Two years later	49,716	99,605	129,114	126,098	143,012	151,542	187,540	215,395			
Three years later	47,660	93,489	127,858	129,688	141,621	158,143	181,832				
Four years later	46,052	98,517	122,428	127,975	140,424	147,474					
Five years later	46,612	90,224	122,009	128,755	138,922						
Six years later	46,749	88,283	123,039	126,011							
Seven years later	47,572	88,968	119,676								
Eight years later	45,854	90,397									
Nine years later	47,555										
Current estimate of cumulative claims	47,555	90,397	119,676	126,011	138,922	147,474	181,832	215,395	259,927	294,163	1,621,352
Cumulative payments to date	(47,452)	(90,365)	(119,061)	(124,665)	(133,043)	(141,934)	(161,600)	(166,328)	(163,175)	(107,381)	(1,255,004)
Liability recognised for 2002 to 2011 accident years	103	32	615	1,346	5,879	5,540	20,232	49,067	96,752	186,782	366,348
Liability recognised in respect of prior accident years											8,343
Claims handling provision											9,217
Provision as at 31 December 2011											**383,908**

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. During the year the Company appointed Threadneedle Asset Management Limited (‘TAM’) to replace Liverpool Victoria Asset Management Limited as its investment manager. All TAM dealings are transacted on an arm’s length basis. 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 monthly 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.

Interest rate risk – fair value

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.

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

Price risk
The Company holds a significant portfolio of equities and Collective Investment Schemes (including hedge funds) which are subject to price movements.

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:

As at 31 December 2011	Sterling £000	USD £000	Euro £000	Other £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**
Derivative financial instruments	**3,530**	**(3,477)**	**-**	**-**	**53**
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					
Subordinated note	**-**	**-**	**(10,023)**	**-**	**(10,023)**
Total	**223,174**	**(220)**	**2,209**	**-**	**225,163**

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

As at 31 December 2010	Sterling £000	USD £000	Euro £000	Other £000	Total £000
Deferred acquisition costs	27,866	-	-	-	27,866
Financial assets at fair value through income					
Shares, other variable yield securities and units in unit trusts	486,316	6,828	31	2,139	495,314
Debt and other fixed income securities	102,047	-	3,419	-	105,466
Loans and other receivables	2,185	-	-	-	2,185
Receivables					
Receivables arising out of broker insurance operations					
- intermediaries	40,727	-	2,684	-	43,411
Receivables arising out of reinsurance operations	208	-	-	-	208
Reinsurers' share of insurance contract liabilities	58,254	-	-	-	58,254
Other assets					
Prepayments and accrued income	3,884	-	-	-	3,884
Deferred tax asset	10,556	-	-	-	10,556
Cash and cash equivalents	31,716	572	17,821	-	50,109
Insurance contracts	(574,931)	-	(13,849)	-	(588,780)
Financial liabilities					
Subordinated note	-	-	(10,282)	-	(10,282)
Derivate financial instruments	9,108	(7,123)	-	(2,108)	(123)
Total	197,936	277	(176)	31	198,068

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 2011 £000	**Impact on equity 2011 £000**	Impact on profit before tax 2010 £000	Impact on equity 2010 £000
Interest rate risk				
+ 50 basis points shift in yield curve	**(4,074)**	**(2,994)**	(5,796)	(4,173)
- 50 basis points shift in yield curve	**4,516**	**3,319**	6,897	4,966
Equity price risk (including derivatives)				
10% increase in equity markets	**3,188**	**2,343**	5,517	3,972
10% decrease in equity markets	**(3,188)**	**(2,343)**	(5,517)	(3,972)

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 2011 was £35.6m (2010: £43.4m), 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 2011	**AAA £000**	**AA £000**	**A £000**	**BBB £000**	**Below 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**

Credit risk exposure 2010	AAA £000	AA £000	A £000	BBB £000	Below BBB £000	Not rated £000	Total £000
Debt and other fixed income securities	103,704	1,167	595	-	-	-	105,466
Short term bank deposits	34,451	-	-	-	-	312	34,763
Reinsurance assets	1,056	15,446	35,595	-	-	6,157	58,254
Total	139,211	16,613	36,190	-	-	6,469	198,483

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
2011 Insurance receivables	**2,468**	**646**	**122**	**410**	**3,646**	**317**	**3,963**
2010 Insurance receivables	4,195	1,001	381	525	6,102	1,284	7,386

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 profile of claim payments 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:

	2011			2010		
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	**608,205**	**1,989**	**610,194**	508,705	92,075	600,780
Derivatives	**53**	**-**	**53**	-	-	-
Insurance receivables	**35,692**	**-**	**35,692**	43,619	-	43,619
Loans and other receivables	**400**	**-**	**400**	2,185	-	2,185
Reinsurance assets	**17,607**	**55,451**	**73,058**	24,568	33,686	58,254
Cash and cash equivalents	**130,399**	**-**	**130,399**	50,109	-	50,109
Total assets	**792,356**	**57,440**	**849,796**	629,186	125,761	754,947

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:

Maturity profile of financial liabilities 2011	**Within 1 year** £000	**1-3 years** £000	**3-5 years** £000	**Over 5 years** £000	**No term** £000	**Total** £000
Insurance contract liabilities	**255,429**	**229,852**	**97,617**	**66,574**	**-**	**649,472**
Financial liabilities	**-**	**-**	**-**	**10,023**	**-**	**10,023**
Insurance payables	**1,365**	**-**	**-**	**-**	**-**	**1,365**
Trade and other payables	**16,737**	**-**	**-**	**-**	**-**	**16,737**
	273,531	**229,852**	**97,617**	**76,597**	**-**	**677,597**

Maturity profile of financial liabilities 2010	Within 1 year £000	1-3 years £000	3-5 years £000	Over 5 years £000	No term £000	Total £000
Insurance contract liabilities	355,620	130,766	55,328	47,066	-	588,780
Financial liabilities	123	-	-	10,282	-	10,405
Insurance payables	617	-	-	-	-	617
Trade and other payables	10,318	-	-	-	-	10,318
	366,678	130,766	55,328	57,348	-	610,120

Strategic risk
Strategic risk is the risk arising from the implementation of the agreed strategy. It includes risks arising from political, economic, sociological and technological changes, competitor actions and capital adequacy.

Executive management identifies strategic risks when drawing up business plans for approval by the Board and monitors these, ensuring that excess risk is reported to the Company Audit, Risk & Compliance Committee and Board.

The Company has not identified any current strategic risks.

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.

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

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).

The following tables present the Company's assets and liabilities measured at fair value at 31 December 2011:

	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**
Forward exchange derivatives	**-**	**53**	**-**	**53**
	16,711	**590,299**	**3,237**	**610,247**

	2010			
	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	15,447	473,009	6,858	495,314
Debt and other fixed income securities	102,500	2,966	-	105,466
	117,947	475,975	6,858	600,780
Forward exchange derivatives	-	(123)	-	(123)
	-	(123)	-	(123)

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 £3,237,000 (2010: £6,858,000).

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

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.

There has been no movement between levels during the year.

Fair value through income:
Shares, other variable yield securities and units in unit trusts

	2011	2010
	£000	£000
Balance at 1 January	**6,858**	29,638
Total loss recorded in comprehensive income	**(205)**	(4,336)
Sales	**(3,416)**	(18,444)
Balance at 31 December	**3,237**	6,858

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

6. Net premium revenue

	2011	2010
	£000	£000
Insurance contracts:		
Premiums written	**394,829**	372,788
Change in unearned premium reserve	**3,279**	(56,515)
Premium revenue arising from insurance contracts issued	**398,108**	316,273
Reinsurance contracts:		
Premiums payable	**(5,227)**	(1,835)
Change in unearned premium reserve	**17**	(3,778)
Premium revenue ceded to reinsurers on insurance contracts issued	**(5,210)**	(5,613)
Net premium revenue	**392,898**	310,660
Motor	**318,743**	308,608
Commercial	**70,738**	-
Property	**-**	193
Legal expenses	**3,417**	1,859
	392,898	310,660

7. Investment income

	2011 £000	2010 £000
Income from investments and cash and cash equivalents:		
- Interest on loans and receivables	**307**	222
- Interest income	**2,048**	14,687
- Dividend income	**18,202**	1,107
	20,557	16,016

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

	2011 £000	2010 £000
(Losses)/gains on financial assets held at fair value through income		
- Debt securities	**(1,312)**	34
- Equity securities	**(646)**	13,971
- Derivative financial instruments	**814**	828
	(1,144)	14,833

Net fair value gains/losses on financial assets held at fair value through income include net realised gains of £1,096,000 (2010: £15,680,000) and net unrealised losses of £2,240,000 (2010: £847,000).

9. Other income

	2011 £000	2010 £000
Commissions receivable	**4,496**	3,976
Deposit interest receivable	**3**	277
	4,499	4,253

10. Insurance claims and loss adjustment expenses

	2011 £000	2010 £000
Gross insurance claims		
Claims paid during the year	**250,936**	229,039
Movement in claims liabilities	**63,971**	20,175
Claims management costs	**13,201**	10,484
	328,108	259,698
Reinsurers share of gross insurance claims		
Claims paid during the year	**(6,748)**	(15,991)
Movement in reinsurers share on claims liabilities	**(14,787)**	43,582
Commutation charge from Highway Insurance Company (Guernsey)	**-**	(21,400)
	(21,535)	6,191
Net insurance claims	**306,573**	265,889

Included within claims incurred is an increase of £19.2m in respect of motor insurance business (2010: £28.1m 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

	2011 £000	2010 £000
Interest payable	**496**	465
	496	465

12. Other operating and administrative expenses

	2011 £000	2010 £000
Investment management expenses and charges	**976**	951
Acquisition expenses	**58,550**	53,054
Movement in deferred acquisition expenses	**(754)**	(10,672)
Administrative expenses	**24,464**	17,029
	83,236	60,362

13. Auditor's remuneration

	2011 £000	2010 £000
Fees payable to Company's auditor for the audit of the Company's accounts	**115**	69
Fees payable to the Company's auditor for other services pursuant to legislation	**10**	23
	125	92

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 and 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:

	2011	2010
	£000	£000
a) Aggregate emoluments	**6,110**	4,418

b) There were £69,867 of contributions to the defined contribution pension scheme (2010: £11,000).

c) Emoluments of the Directors were as follows:

	Salary	**Bonus**	**Other Benefits**	**Long Term Incentive Plan**	**Compensation for loss of office**	**Total 2011**	Total 2010
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	£000
Highest paid Director	**491**	**518**	**123**	**1,046**	**-**	**2,178**	1,247
All Directors	**2,417**	**1,526**	**209**	**1,838**	**120**	**6,110**	4,418

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 2011 or 2010.

d) Pension arrangements
P M Bunker, P A Horton, S V Castle, J B O'Roarke, and S Haynes* 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 17.1% of pensionable salaries (2010: 19% of pensionable salaries) in respect of all permanent staff, including executive directors. This included amounts on behalf of executive directors of £193,078 (2010: £274,000).

*Pro rata for the part of the year until appointing/resigning as a director.

	2011	2010
Accrued pension at end of period	**£000**	£000
All Directors	**193**	112

15. Income tax expense

a) Current year tax expense

	2011 £000	2010 £000
Current year tax expense		
Prior year adjustment	**325**	1,271
Total current tax	**325**	1,271
Deferred tax expense		
Deferred tax credit	**7,047**	5,616
Prior year adjustment	**(795)**	(1,075)
Total movement in deferred tax	**6,252**	4,541
Total income tax expense	**6,577**	5,812

b) Reconciliation of tax expense

The tax assessed for the period is lower than the standard rate of corporation tax in the UK (26.5%). The differences are explained below:

	2011 £000	2010 £000
Profit before tax	**26,505**	19,046
Profit multiplied by standard rate of corporation tax in the UK of 26.5% (2010: 28%)	**7,023**	5,333
Effects of:		
Impact of change in UK corporation tax rate on deferred tax	**525**	282
Income not subject to Corporation Tax	**(501)**	-
Adjustments to tax charge in respect of prior years	**(470)**	197
Total income tax expense for the year	**6,577**	5,812

The standard rate of Corporation Tax in the UK changed from 28% to 26% with effect from 1 April 2011. Accordingly, the profits for this accounting period are taxed at an effective rate of 26.5%

16. Deferred acquisition costs

	2011 £000	2010 £000
At 1 January	**27,866**	17,194
Acquisition expenses deferred	**58,550**	53,054
Amortisation	**(57,797)**	(42,382)
At 31 December	**28,619**	27,866

17. Financial assets

	2011 £000	2010 £000
Fair value through income		
Shares, other variable yield securities and units in unit trusts	**607,866**	495,314
Debt and other fixed income securities	**2,328**	105,466
	610,194	600,780
Loans and other receivables		
Amounts due from group undertakings	**-**	1,414
Other receivables	**400**	771
	400	2,185
	610,594	602,965

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

18. Insurance receivables

	2011 £000	2010 £000
Receivables arising from insurance and reinsurance contracts:		
- Due from intermediaries	**35,579**	43,411
- Due from reinsurers	**113**	208
	35,692	43,619

As at 31 December 2011 overdue insurance receivables arising from insurance contracts were provided at £317,000 (2010: £1,284,000).

19. Reinsurance assets

	2011 £000	2010 £000
Reinsurers' share of provision for unearned income	**17**	-
Reinsurers' share of claims outstanding	**73,041**	58,254
	73,058	58,254

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

20. Prepayments and accrued income

	2011 £000	2010 £000
Accrued interest	**1,939**	3,465
Prepayments	**-**	419
	1,939	3,884

21. Deferred tax asset

	2011 £000	2010 £000
At 1 January	**10,556**	15,098
Current year charge	**(6,252)**	(4,542)
At 31 December	**4,304**	10,556

Analysis of deferred taxation temporary differences:

	2011 £000	2010 £000
Advanced capital allowances	**492**	664
Taxable losses carried forward	**3,812**	9,892
	4,304	10,556

The analysis of the deferred tax balance is as follows:

	2011 £000	2010 £000
Deferred tax asset expected to be recovered after more than 12 months	**392**	530
Deferred tax asset expected to be recovered within 12 months	**3,912**	10,026
Net deferred tax asset	**4,304**	10,556

The valuation and recoverability of deferred tax assets relating to tax losses and capital allowances in excess of depreciation is dependant on the availability of future taxable profits within the company. Management of forecasts currently support the future recoverability of the deferred tax asset recognised in the statement of financial position as at 31 December 2011.

Deferred tax balances have been measured taking into account the change in the rate of UK corporation tax from 26% to 25%. This change was substantively enacted on 5 July 2011 and will be effective from 1 April 2012.

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 March 2011 UK Budget Statement. Further reductions to the main rate are proposed to reduce the rate by 1% per annum to 23% by 1 April 2014. These further changes had not been substantively enacted at the statemnt of financial position date and, therefore, are not included in these financial statements.

22. Current tax

	2011 £000	2010 £000
At 1 January	**-**	6,048
Amounts recorded in the income statement	**(325)**	(1,271)
Tax refund received	**-**	(6,048)
Group relief received	**-**	1,271
Relief for tax losses b/f	**325**	-
At 31 December	**-**	-

23. Cash and cash equivalents

	2011 £000	2010 £000
Bank balances	**3,280**	15,346
Short term bank deposits	**127,119**	34,763
Cash and cash equivalents	**130,399**	50,109

24. Insurance contract liabilities

a) Analysis of insurance contracts

	2011			2010		
	Gross £000	**Reinsurance £000**	**Net £000**	Gross £000	Reinsurance £000	Net £000
General insurance claims liabilities	**456,949**	**(73,041)**	**383,908**	392,978	(58,254)	334,724
General insurance unearned premiums	**192,523**	**(17)**	**192,506**	195,802	-	195,802
	649,472	**(73,058)**	**576,414**	588,780	(58,254)	530,526

b) Movement in general insurance claims liabilities

	2011			2010		
	Gross £000	**Reinsurance £000**	**Net £000**	Gross £000	Reinsurance £000	Net £000
OCR	**428,263**	**(51,467)**	**376,796**	409,624	(103,248)	306,376
IBNR	**(35,285)**	**(6,787)**	**(42,072)**	(36,821)	1,412	(35,409)
Balance at 1 January	**392,978**	**(58,254)**	**334,724**	372,803	(101,836)	270,967
Movement in claims incurred in prior accident years	**17,761**	**(18,345)**	**(584)**	(24,356)	8,001	(16,355)
Claims incurred in the current accident year	**297,146**	**(3,190)**	**293,956**	273,570	(3,902)	269,668
Claims paid during the year	**(250,936)**	**6,748**	**(244,188)**	(229,039)	15,991	(213,048)
Commutation of quota share reinsurance	**-**		**-**	-	23,492	23,492
	63,971	**(14,787)**	**49,184**	20,175	43,582	63,757
Balance at 31 December	**456,949**	**(73,041)**	**383,908**	392,978	(58,254)	334,724
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 31 December	**456,949**	**(73,041)**	**383,908**	392,978	(58,254)	334,724

c) Movement in general insurance unearned premiums

	2011			2010		
	Gross £000	**Reinsurance £000**	**Net £000**	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	**195,802**	**-**	**195,802**	139,287	(3,778)	135,509
Premiums written in the year	**394,829**	**(5,227)**	**389,602**	372,788	(1,835)	370,953
Premiums earned during the year	**(398,108)**	**5,210**	**(392,898)**	(316,273)	5,613	(310,660)
Balance at 31 December	**192,523**	**(17)**	**192,506**	195,802	-	195,802

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 a provision for the claims and expenses attributable to the unexpired risk from business written prior to the statement of financial position date.

25. Derivative financial instruments

The Company utilises the following derivative instruments for hedging the effect of changes in exchange rate borrowings on its fixed rate bond portfolio. Fair values are estimated using current market interest rate data and are included in assets or liabilities as set out in the following table:

	2011			2010		
	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 derivatives	**3,472**	**-**	**(5)**	9,231	-	(123)
Stock Index futures	**1,382**	**58**	**-**	-	-	-
	4,854	**58**	**(5)**	9,231	-	(123)

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

26. Other financial liabilities

	2011	2010
	£000	£000
Subordinated note	**10,023**	10,282
	10,023	10,282

€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%.

27. Insurance payables

	2011	2010
	£000	£000
Due to reinsurers	**1,365**	617
	1,365	617

28. Trade and other payables

	2011	2010
	£000	£000
Amounts due to group undertakings	**5,589**	-
Trade payables	**576**	434
Other taxes and social security costs	**5,378**	4,838
Other payables	**40**	60
Accruals and deferred income	**5,154**	4,986
	16,737	10,318

29. Share capital

	2011	2010
	£000	£000
Allotted and fully paid		
75,000,000 (2010: 75,000,000) ordinary shares of £1 each	**75,000**	75,000

During 2010 the Company adopted new Articles of Association in line with the Companies Act 2006 and no longer has an authorised share capital.

30. Capital reserve

	2011	2010
	£000	£000
Balance at 1 January	**150,000**	110,000
Additions	**-**	40,000
Balance at 31 December	**150,000**	150,000

The Company received no contributions from Highway Insurance Group Limited in 2011 and the following was received during 2010:

	£000
16 July 2010	15,000
22 October 2010	10,000
15 December 2010	10,000
20 December 2010	5,000
Total 2010	40,000

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

31. Accumulated losses

	2011	2010
	£000	£000
Balance at 1 January	**(37,867)**	(51,101)
Profit for the year	**19,928**	13,234
Balance at 31 December	**(17,939)**	(37,867)

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

	2011 £000	2010 £000
Profit before tax	**26,505**	19,046
Investment income	**(20,557)**	(16,016)
Gains/(losses) on financial assets recorded in the statement of comprehensive income	**1,144**	(14,833)
Exchange (losses) on financial assets recorded in the statement of comprehensive income	**(259)**	(380)
Finance costs	**496**	465
Purchase of investments at fair value through income	**(364,143)**	(1,325,456)
Sales of investments at fair value through income	**373,966**	1,139,770
Non cash items		
Expenses deferred during the year	**(58,550)**	(53,054)
Amortisation of deferred acquisition costs	**57,797**	42,382
Changes in working capital		
(Increase)/decrease in reinsurance assets	**(14,804)**	47,360
(Increase)/decrease in insurance and other receivables	**9,387**	(2,596)
Decrease in other prepayments and accrued income	**1,945**	3,323
Increase in insurance contract liabilities	**60,692**	76,690
Increase/(decrease) in insurance payables	**748**	(3,086)
Increase in trade and other payables	**6,419**	1,797
Cash generated from/(used in) from operating activities	**80,786**	(84,588)

33. Related party transactions

The Company did not directly enter into transactions with key management personnel, all transaction 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:

	2011	2010
	£000	£000
Short-term employee benefits	**4,152**	4,126
Post employee benefits	**263**	112
Other long-term benefits	**1,838**	
Termination benefits	**120**	292
	6,373	4,530

	2011	2010
	£000	£000
Reinsurance transactions with group undertakings (Highway Insurance Guernsey Limited)	**-**	(1,616)
Capital contribution (Highway Insurance Group Limited)	**-**	40,000
Management charge from group undertakings (Liverpool Victoria Insurance Management Limited)	**(33,575)**	(26,484)
	(33,575)	11,900

Balances outstanding between the Company and other Group companies:

	2011	2010
	£000	£000
Other balances (payable)/receivable by the Company (LVFS)	**(5,589)**	1,414
	(5,589)	1,414

34. Ultimate parent company

The ultimate parent company 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 (formerly Highway Insurance Group Plc), a limited liability company, incorporated in the UK.

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

The largest and smallest company whose accounts this company is consolidated into is Liverpool Victoria Friendly Society 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