COMPANY REGISTRATION NUMBER: 0003232514

LIVERPOOL VICTORIA INSURANCE COMPANY LIMITED

REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

CONTENTS

DIRECTORS, OFFICERS AND REGISTERED OFFICE

Directors

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

Company secretary

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

Registered office

County Gates
Bournemouth
BH1 2NF

Tel: 01202 292333
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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 Liverpool Victoria Insurance Company Limited (the 'Company', 'LVIC') for the year to 31 December 2012.

1. Results and dividends

The profit on ordinary activities for the year after taxation is £65,252,000 (2011: £38,658,000) as set out on page 9. The directors proposed and paid £37,500,000 in interim dividends in the current year (2011: £nil).

2. Principal activities

The principal activity of the Company is to carry on general insurance business through both the direct and broker distribution channels. The primary sources of premium income are from the sale of Motor and Home products. The Company also underwrites Road Rescue, Pet and Travel Insurance, and Commercial Insurance for Small and Medium Size Enterprises ('SME').

3. Business review and developments

(a) Results & performance

The 2012 results for the Company show a profit before taxation of £85,750,000. This continues the profitable growth trend reported in recent years and demonstrates that the Company results are developing in line with its strategic objectives.

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

1. Premium income growth: The Company has seen a moderate level of income growth in 2012. This was achieved despite the increased price competition (particularly for Motor products) seen across all distribution channels. The overall growth was achieved primarily through the Company's Direct channel.

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

3. Expenditure: Investment in staff, systems and infrastructure has continued ensuring that the Company is well placed to deliver its profitable growth strategy. In addition, continued expenditure was incurred on direct marketing activities (including TV commercials) aimed at promoting the LV= brand. Notwithstanding this the Company still delivered an improved expense ratio in 2012. The improved expense ratio was achieved as a result of good cost management processes and economies of scale due to the substantial growth achieved by the business in the recent years.

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

5. Direct Division: The Direct Division operates under the LV= brand and the Britannia brand. Under the LV= brand it offers personal lines products including Motor, Home, travel and Pet insurance. Road Rescue is offered under the Britannia Rescue brand. The Direct Division has continued to grow during 2012 writing premiums of £830m (2011: £736m).

   Broker Division: The Broker Division offers both personal lines (primarily Motor) and Commercial SME products under the ABC Insurance brand. During 2012 this brand wrote premiums of £323m (2011: £325m). This division wrote less business in 2012, as it prioritised the achievement underwriting margin targets over business volume growth.

6. The Company owns Highway Insurance Group Limited ('HIG') which forms part of the Broker Division; the results of this Company are not consolidated with those of the Company.

The management views 2012 as a year where it has been able to demonstrate that it can deliver strong and sustainable profits, whilst maintaining steady overall premium growth in an increasingly competitive market.

(b) Business environment

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

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

(c) Strategy

The Company is the major part of the 'LVGIG' Group of companies. The long term objective of LVGIG (and its subsidiaries) is as follows:

"To maintain its position as a top five general insurer in its target markets and to be active in all major channels: direct, broker, affinity and white-label.
It will be focused on three core products, namely Motor, Home and Commercial supported by more minor lines such as Road Rescue, Travel and Pet and will utilise a range of strong brands including LV=, Highway, ABC and Britannia Rescue. The Group will operate best-practice processes and technology in order to provide superior customer service through a people-focused and empowered culture. The Company will ultimately deliver attractive and consistent returns to members of Liverpool Victoria Friendly Society ('LVFS')."

(d) Principal risks and uncertainties

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

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

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

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

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

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

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

A statement of how the Company manages its principal types of risk is disclosed in note 5 of the financial statements.

(e) Future outlook
It is projected that the Company will steadily continue to increase its premium income in 2013 and beyond. This growth will come from moderate volume increases both from Direct and Broker operations. However it should be noted that the volume growth will not be pursued at the expense of lower margins. The Company expects to deliver an improved underwriting profit in 2013.

(f) Significant post statement of financial position events
There have been no events affecting the Company since the statement of financial position date.

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

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

KPI	2012	2011	Comments
Premiums written	£1,153m	£1,061m	Premiums written by the Company are showing a moderate year on year growth. This was achieved despite the increased competition seen specifically in relation to the Motor market.
Underwriting loss ratio	76.4%	73.0%	An overall loss ratio of 76.4% was reported for 2013. The year was affected by a number of adverse weather events which occurred throughout the year. In addition claims reserves were strengthened primarily in response to the impact of various legal and regulatory developments.
Expense ratio *	22.3%	24.6%	The net expense ratio (including other income) of 22.3% is showing a year on year improvement of 2.3%. The Company continues to benefit from the investments made in previous years, increased operational efficiency and economies of scale.
Combined ratio	98.7%	97.6%	The combined ratio of 98.7% reported by the Company is affected by the loss ratio experience described above. The Company nevertheless expects to compare well with the overall market for 2012.
Investment return	£74m	£29m	Total investment return includes: 1. Investment income and 2. Net fair value gains/losses on financial assets The total investment return has more than doubled compared with 2011. The Company has benefitted from increased funds under management and a proactive investment management strategy.
Net assets	£588m	£561m	Net assets have increased during 2012 to £588m reflecting the strong post tax profits made by the Company in 2012. This increase was achieved notwithstanding the fact that the Company paid a dividend of £37.5m during the year.

* Expense ratio excludes amortisation of goodwill and investment management costs.

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

5. Parent company
The Company is a wholly owned subsidiary of LVGIG. The ultimate parent company is LVFS, a friendly society incorporated under the Friendly Societies Act 1992.

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

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

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

- so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware, and
- he has taken all 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. Director's 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 year on behalf of its subsidiaries Directors' and Officers' liability insurance in respect of LVIC and its Directors. It is available for inspection at the registered office of LVIC details of which are provided on page 1.

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

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

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

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

On behalf of the Board of Directors

S V Castle
Director

21 February 2013

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

Respective responsibilities of directors and auditors

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

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

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements:

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

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

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

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

21 February 2013

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	**2012** £000	2011 £000
Insurance contract premium revenue	6	**1,127,022**	934,823
Insurance contract premium ceded to reinsurers	6	**(27,126)**	(19,622)
Net premium revenue		**1,099,896**	915,201
Investment income	7	**48,317**	29,370
Net fair value gains/(losses) on financial assets at fair value through income	8	**25,355**	(706)
Other income	9	**32,306**	27,653
Total income		**1,205,874**	971,518
Insurance claims and loss adjustment expenses	10	**(859,592)**	(678,118)
Insurance claims and loss adjustment expenses recoverable from reinsurers	10	**19,158**	10,368
Net insurance claims		**(840,434)**	(667,750)
Other operating and administrative expenses	11	**(279,690)**	(254,711)
Total claims and expenses		**(1,120,124)**	(922,461)
Profit before tax		**85,750**	49,057
Income tax expense	14	**(20,498)**	(10,399)
Profit for the year attributable to owners		**65,252**	38,658
Total comprehensive income for the year		**65,252**	38,658

All balances relate to continuing business.

The notes on pages 13 to 45 are an integral part of the financial statements.

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

		Attributable to equity holder of the Company			
		Share capital	**Retained earnings**	**Capital reserve**	**Total**
	Note	**£000**	**£000**	**£000**	**£000**
Balance at 1 January 2012		344,908	(62,220)	278,044	560,732
Dividends	31	-	-	(37,500)	(37,500)
Profit for the year	32	-	65,252	-	65,252
Balance at 31 December 2012		**344,908**	**3,032**	**240,544**	**588,484**

		Attributable to equity holder of the Company			
		Share capital	Accumulated losses	Capital reserve	Total
	Note	£000	£000	£000	£000
Balance at 1 January 2011		344,908	(100,878)	274,044	518,074
Capital contributions	31	-	-	4,000	4,000
Profit for the year	32	-	38,658	-	38,658
Balance at 31 December 2011		344,908	(62,220)	278,044	560,732

The notes on pages 13 to 45 are an integral part of the financial statements.

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2012

	Note	2012 £000	2011 £000
Assets			
Investments in group undertakings	15	**301,012**	301,012
Intangible assets	16	**18,332**	18,512
Deferred acquisition costs	17	**73,240**	66,069
Financial assets			
- Fair value through income	18	**1,262,218**	950,277
- Derivative financial instruments	19	**1,435**	-
Loans and other receivables	20	**25,175**	24,010
Insurance receivables	21	**183,828**	170,439
Reinsurance assets	22	**54,296**	40,875
Prepayments and accrued income	23	**20,047**	3,907
Cash and cash equivalents	24	**113,759**	194,136
Total assets		**2,053,342**	1,769,237
Liabilities			
Insurance contract liabilities	25	**1,366,956**	1,127,760
Insurance payables	26	**10,081**	8,669
Deferred tax liability	27	**663**	556
Current tax liability	28	**11,783**	1,434
Trade and other payables	29	**75,375**	70,086
Total liabilities		**1,464,858**	1,208,505
Equity			
Share capital	30	**344,908**	344,908
Capital reserve	31	**240,544**	278,044
Retained earnings/(accumulated losses)	32	**3,032**	(62,220)
Total equity		**588,484**	560,732
Total liabilities and equity		**2,053,342**	1,769,237

The notes on pages 13 to 45 are an integral part of the financial statements.

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

Signed on behalf of the Board of Directors

J B O'Roarke
Director

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	2012 £000	Restated (see note 2) 2011 £000
Cash and cash equivalents at 1 January	24	**194,136**	57,105
Cash flows arising from:			
Operating activities			
Cash (used in)/generated from operating activities	33	**(87,562)**	88,599
Dividend income received		**15,353**	26,026
Interest income received		**39,374**	21,694
Payments made in respect of group relief	28	**(1,472)**	(3,288)
Income tax paid	28	**(8,570)**	-
Net cash (used in)/generated from operating activities		**(42,877)**	133,031
Financing activities			
Proceeds from capital contribution	31	**-**	4,000
Dividends paid	31	**(37,500)**	-
Net cash (used in)/from financing activities		**(37,500)**	4,000
Net (decrease)/increase in cash and cash equivalents		**(80,377)**	137,031
Cash and cash equivalents at 31 December	24	**113,759**	194,136

The notes on pages 13 to 45 are an integral part of the financial statements.

1. General information

Liverpool Victoria Insurance Company Limited is a company limited by shares, domiciled and incorporated in the United Kingdom. The Company underwrites general insurance risks, including motor and household risks. All contracts of insurance are written in the United Kingdom or the Channel Islands.

2. Basis of presentation

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

These accounts have been prepared under the historic cost convention, as modified by the revaluation of financial assets and liabilities at fair value through income. The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

The preparation of the accounts in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the accounts are disclosed in note 4.

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

Insurance contracts are accounted for in accordance with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005, and amended in December 2006.

Restatement

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

3. Accounting policies

Premiums

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

Reinsurance contracts

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

An impairment review is performed at the statement of financial position date. Impairment occurs when there is evidence that the Company will not recover outstanding amounts under the contract, such losses being recorded immediately in the statement of comprehensive income.

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

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

Unrealised gains and losses on financial assets represent the difference between the valuation of fair value investments at the statement of financial position date and their purchase price or, if they have been previously revalued, their valuation at the last statement of financial position date. An adjustment is made to unrealised gains and losses for the prior year's unrealised element included in the current year's realised gains and losses.

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

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

- Deferred tax
Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the Company controls the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Foreign currencies
Monetary assets and liabilities denominated in foreign currencies are translated to the functional currency of the company at rates of exchange ruling at the end of the year. Purchases and sales of investments denominated in foreign currencies are translated at the rates prevailing at the dates of the respective transactions. Exchange gains and losses are recognised within the statement of comprehensive income.

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

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

Liability adequacy test
At each statement of financial position date liability adequacy tests are performed to ensure the adequacy of insurance contract liabilities, net of related DAC. In performing these tests current best estimates of future contractual cash flows and claims handling and administration expenses as well as investment income from the assets backing such liabilities are used. Any deficiency is immediately charged to the statement of comprehensive income initially by writing off DAC and by subsequently establishing an unexpired risk provision.

Goodwill
Goodwill represents the excess of the cost of an acquisition over the fair value of the net identifiable assets of the acquired book of business at the acquisition date. Goodwill is reviewed for impairment at the end of the first full year of acquisition. Thereafter, it is tested at each statement of financial position date for impairment against the value in use and carried in the statement of financial position at cost less accumulated impairment losses.

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

The expected economic life of other intangibles is determined by reference to the future revenue streams arising from the acquired business and is within the range of 10 to 20 years.

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

Derivative financial instruments
Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value.

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

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

Financial assets at fair value through income
All investments of the Company classified as fair value are designated as fair value through income at inception. Such assets are valued at market prices, or prices consistent with market ratings should no price be available. Any unrealised or realised gains or losses are taken to the statement of comprehensive income, as fair value gains or losses, or realised gains or losses respectively, as they occur.

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

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

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

Impairment of assets
The Company assesses at each statement of financial position whether there is objective evidence that a financial asset or group of financial assets is impaired. Impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of financial assets is impaired includes observable data that comes to the attention of the Company about the following events:

(i) significant financial difficulty of the issuer or debtor;

(ii) a breach of contract, such as a default or delinquency in payments;

(iii) observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group.

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

Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income.

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.

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.

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

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

Standard actuarial claims projection techniques are used to estimate outstanding claims. Such methods extrapolate the development of paid and incurred claims, recoveries from third parties, average cost per claim and ultimate claim numbers for each accident year, based upon the observed development of earlier years and expected loss ratios. The main assumption underlying these techniques is that past claims development experience can be used to project ultimate claims costs. Allowance for one off occurrences or changes in legislation, policy conditions or portfolio mix, is also made in arriving at the estimated ultimate cost of claims, in order that it represents the most likely outcome, taking account of all the uncertainties involved. To the extent that the ultimate cost is different from the estimate, where experience is better or worse than that assumed, the surplus or deficit will be credited or charged to the statement of comprehensive income in future years.

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

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

Dividend distribution
Dividend distribution to the Company's equity shareholder is recognised in equity in the period in which the dividend is paid.

Consolidation
The accounts present information about the Company as an individual undertaking and not about its group. The Company has not prepared group accounts as it is exempt from the requirement to do so by section 400 of the Companies Act 2006, as it is a subsidiary undertaking of Liverpool Victoria General Insurance Group Limited, a company incorporated in England and is included in the consolidated accounts of Liverpool Victoria General Insurance Group Limited.

CHANGES IN ACCOUNTING POLICIES

(i) New and amended standards adopted by the Company

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

(ii) New standards and interpretations not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2012, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the company, except the following set out below:

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

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

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

IFRS 12, 'Disclosures of interests in other entities', includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet 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, subject to endorsement by the EU.

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

4. Significant accounting judgements, estimates and assumptions

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

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

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

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

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

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

Estimation of the ultimate cost of bodily injury claims is a complex process and cannot be done using conventional actuarial techniques. Significant factors that affect the trends that influence the bodily injuries estimation process are inconsistent court resolutions and jurisprudence that have broadened the intent and scope of coverage of the protection offered in the insurance contracts issued by the Company. This factor is exacerbated by the Company's bodily injury claims. The current case law can be characterised as still evolving; it is unlikely that any firm direction will emerge in the courts' compensation methods in the near future. Due to this uncertainty, it is not possible to determine the future development of bodily injury claims with the same degree of reliability as with other types of claims. A recent legislative development is the prevalence of Periodic Payment Order (PPO) claims. These claims have an annuity-type structure, i.e. they are typically paid annually over the claimant's life. Courts may decide that a claim should be paid on a PPO basis, but in some cases the claimant will request such a settlement. Market data analysis suggests that circa 35% of claims costing in excess of £1m are now settling on a PPO basis and therefore these claims are representing a greater proportion of the liabilities year-on-year. As it is unclear whether a large claim will settle on a PPO basis or on the traditional lump sum basis, there is further uncertainty in the bodily injury projections. A further complexity of PPO claims is that due to the annuity type structure of the claim payments, the estimation of ultimate claims cost now involves projecting mortality rates, discount rates and benefit indexation rates, which is unlike all other general insurance liabilities.

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 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 LVIC 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 LVIC's best estimate is assessed.

Other

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

5. Capital management and risk management and control

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

The Company retains capital to meet four key objectives:

(i) To ensure financial stability;
(ii) To enable the Company's strategy to be implemented;
(iii) To give confidence to policyholders and other stakeholders who have relationships with the Company; and
(iv) To comply with capital requirements imposed by its UK regulator, the Financial Services Authority.

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

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

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

The Company had capital available of £588,484,000 (2011: £560,732,000) being net assets available to the company.

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

Risk management and control
The principal types of risk, which are detailed below, have been identified and risk appetite for each of these has been set by reference to the FSA's Individual Capital Assessment (ICA) capital requirements.

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

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

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

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Company faces under its insurance contracts is the risk that actual claims exceed the carrying value of the Company's insurance liabilities. The risk arises from the inherent uncertainties as to the occurrence, amount and timing of insurance claims. For general insurance contracts this is primarily represented by exposure to risks which may lead to significant claims in terms of frequency or value. These would include significant weather events, subsidence and large single claims arising from either the motor business (injury claims) or SME business (liability and/or property claims). 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.

Property business (domestic and commercial) is exposed to catastrophic risks such as result from storms or floods as well as risks such as subsidence. The Company has entered into reinsurance contracts which provide protection against catastrophic weather events.

Motor business is exposed to the risk of large personal injury claims, where the claim amounts can be significant due to the cost of care required for the claimant. The Company has entered into excess of loss reinsurance contracts which reduce its exposure to large claims. The Company's retention is £5.0m per claim (2011: £5.0m per claim).

Commercial business is exposed to large individual property losses and also to liabilities arising from employment and commercial activities. The Company has entered into reinsurance contracts which provide protection against these liabilities.

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

The table below sets out the concentration of General Insurance contract liabilities by type of contract:

	2012			2011		
	Gross	**Reinsurance**	**Net**	Gross	Reinsurance	Net
	£000	**£000**	**£000**	£000	£000	£000
Motor	**663,514**	**(31,329)**	**632,185**	477,860	(26,358)	451,502
Household	**57,711**	**(226)**	**57,485**	53,858	-	53,858
Travel	**991**	**-**	**991**	990	-	990
Commercial	**60,537**	**(8,028)**	**52,509**	37,231	(1,510)	35,721
Other	**3,438**	**-**	**3,438**	2,930	-	2,930
	786,191	**(39,583)**	**746,608**	572,869	(27,868)	545,001

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

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

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

The Company has identified two specific areas of uncertainty that it has explicitly allowed for within the claims provision but where the outcome could be worse than the amount allowed for. These are:

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

The claims provision includes a specific allowance for claims identified as having the potential to settle on a PPO basis. This allowance is based on the mean cost of claims derived from a range of scenarios based on the PPO settlement rate for these claims. If all of these claims were to settle as PPOs, the reserves would deteriorate by an estimated £3.8m from the position shown above.

The Ogden discount rate is set by the Lord Chancellor. It is currently 2.5% but a revision is under consideration with a decision possible by late 2013. Whilst there are many views across the industry in terms of what the change should be, the general consensus is that a reduction in the rate is likely. The claims provision has included an allowance for a change in the Ogden discount rate, using a scenario based approach as for PPOs. The allowance is broadly equivalent to a reduction in the discount rate to 1.75%. If the discount rate was to reduce to 1.5%, the claims provision would deteriorate by £2.8m. A reduction to 1% would lead to a deterioration of £8.8m.

The claims provision is also sensitive to the number and cost of large motor claims (defined as greater than £1m), which have been incurred but not reported and reserved. We would typically expect a number of large claims from expired risks to be identified in the future, either from being newly reported or from existing claims increasing in magnitude above the £1m threshold. The claims provision allows for £15m of late reported / reserved large claims. Therefore, if four new claims at £5m each were reported, for example this would lead to a £5m deterioration in the reserves, whereas two new £5m claims would lead to a £5m improvement.

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

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

Analysis of claims development – gross of reinsurance

Accident year	**2003 £m**	**2004 £m**	**2005 £m**	**2006 £m**	**2007 £m**	**2008 £m**	**2009 £m**	**2010 £m**	**2011 £m**	**2012 £m**	**Total £m**
Initial estimate of gross provision	261.4	314.5	336.2	366.4	373.4	331.2	375.9	523.5	620.0	803.7	
One year later	260.5	307.4	332.4	347.5	315.8	296.6	362.8	548.3	632.9		
Two years later	253.5	286.7	315.2	325.4	290.9	280.2	356.8	555.5			
Three years later	235.2	281.0	300.5	310.8	285.3	278.0	353.4				
Four years later	230.1	270.8	296.0	303.3	284.8	277.4					
Five years later	226.4	269.5	293.1	303.1	284.7						
Six years later	226.5	269.6	295.1	302.1							
Seven years later	226.2	269.7	293.1								
Eight years later	226.2	269.7									
Nine years later	228.0										
Current estimate of cumulative claims	228.0	269.7	293.1	302.1	284.7	277.4	353.4	555.5	632.9	803.7	4,000.4
Cumulative payments to date	(225.0)	(269.2)	(292.3)	(299.4)	(278.3)	(264.0)	(314.6)	(460.6)	(463.0)	(361.3)	(3,227.6)
Liability recognised for 2003 to 2012 accident years	3.0	0.5	0.8	2.7	6.4	13.4	38.8	94.9	169.9	442.4	772.8
Liability recognised in respect of prior accident years											1.2
Claims handling provision											12.2
Provision as at 31 December 2012											786.2

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

Analysis of claims development – net of reinsurance

Accident year	**2003 £m**	**2004 £m**	**2005 £m**	**2006 £m**	**2007 £m**	**2008 £m**	**2009 £m**	**2010 £m**	**2011 £m**	**2012 £m**	**Total £m**
Initial estimate of net provision	259.4	314.5	336.2	366.4	369.1	327.5	372.6	518.2	613.8	792.5	
One year later	258.4	307.4	332.4	345.4	311.4	291.7	356.9	542.8	619.7		
Two years later	253.2	286.7	313.1	324.0	288.6	276.4	345.7	549.4			
Three years later	234.7	279.1	299.8	309.8	283.0	274.9	342.1				
Four years later	229.0	270.8	295.5	303.3	282.6	273.8					
Five years later	226.4	269.5	293.1	302.9	283.5						
Six years later	226.5	269.6	295.1	302.1							
Seven years later	226.2	269.7	293.1								
Eight years later	226.2	269.7									
Nine years later	228.0										
Current estimate of cumulative claims	228.0	269.7	293.1	302.1	283.5	273.8	342.1	549.4	619.7	792.5	3,953.9
Cumulative payments to date	(225.0)	(269.2)	(292.3)	(299.4)	(277.5)	(264.0)	(314.6)	(459.2)	(458.0)	(361.3)	(3,220.4)
Liability recognised for 2003 to 2012 accident years	3.0	0.5	0.8	2.7	6.0	9.8	27.5	90.2	161.7	431.2	733.5
Liability recognised in respect of prior accident years											0.9
Claims handling provision											12.2
Provision as at 31 December 2012											746.6

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

Market risk

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

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

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

Interest rate risk

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

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

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

Credit spread risk

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

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

Price risk

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

Currency risk

Although the company operates only within the UK, it has exposure to foreign currencies through its investment portfolio.

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. The Company purchases forward foreign exchange contracts to hedge the exposure to foreign exchange movements.

The Company did not have any exposure to foreign exchange risk as at 31 December 2012 and 2011.

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

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 indicated the effect of changes in market risk factors arising from the impact of the changes in these factors on the Company's financial assets and liabilities.

	Impact on profit before tax 2012 £000	**Impact on equity 2012 £000**	Impact on profit before tax 2011 £000	Impact on equity 2011 £000
Interest rate risk				
+ 50 basis points shift in yield curve	**(66)**	**(50)**	(6,454)	(4,744)
- 50 basis points shift in yield curve	**66**	**50**	6,595	4,847
Credit spread risk				
100 basis points widening in all credit spreads	**(21,593)**	**(16,303)**	(12,772)	(9,387)
100 basis points tightening in all credit spreads	**22,562**	**17,034**	13,334	9,800
Equity price risk (including derivatives)				
20% increase in equity markets	**1,774**	**1,339**	9,110	6,696
20% decrease in equity markets	**(1,774)**	**(1,339)**	(9,110)	(6,696)

Credit risk

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

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

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

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

Exposure to insurance intermediaries risk is managed via a stringent credit policy. The Company's credit control function monitors the ageing and collectability of debtor balances, with credit evaluations performed on all relevant counterparties. The Company does not require collateral in respect of financial assets. Intermediary debt at 31 December 2012 was £36.7 million (2011: £39.2 million), 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.

Exposure to policyholder risk is managed by a credit default policy. The policy servicing function monitors the ageing of policyholder balances, where policies are sold on instalment terms, and will cancel policies at the point of default. When the debt goes into arrears it is managed to ensure it is collected where possible.

In addition to the above the Company also monitors the debt via the Risk Committee and Intermediary Collection Committees and provides against older debts.

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

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

Credit risk exposure 2012	**AAA £000**	**AA £000**	**A £000**	**BBB £000**	**Not rated £000**	**Total £000**
Debt and other fixed income securities	378,563	94,906	319,171	232,386	-	1,025,026
Short term bank deposits	-	12,622	105,676	-	-	118,298
Reinsurance assets	-	38,214	13,339	978	1,765	54,296
Total	**378,563**	**145,742**	**438,186**	**233,364**	**1,765**	**1,197,620**

Credit risk exposure 2011	AAA £000	AA £000	A £000	BBB £000	Not rated £000	Total £000
Short term bank deposits	-	35,997	150,515	-	-	186,512
Reinsurance assets	1,872	20,607	15,974	-	2,422	40,875
Total	1,872	56,604	166,489	-	2,422	227,387

The tables below show the age analysis of the company's past due and/or impaired assets

Age analysis of assets past due/impaired 2012	**<31days £000**	**31 to 60 days £000**	**61 to 90 days £000**	**>90 days £000**	**Total past due but not impaired £000**	**Past due and impaired £000**	**Total £000**
Financial assets							
Insurance receivables	**2,699**	**554**	**116**	**200**	**3,569**	**(456)**	**3,113**

Age analysis of assets past due/impaired 2011	<31days £000	31 to 60 days £000	61 to 90 days £000	>90 days £000	Total past due but not impaired £000	Past due and impaired £000	Total £000
Financial assets							
Insurance receivables	2,637	574	133	287	3,631	(316)	3,315

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

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

The Company'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 and policy holders.

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

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

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

	2012			2011		
	Within 1 year	**Over 1 year**	**Total**	Within 1 year	Over 1 year	Total
Maturity profile of financial assets	**£000**	**£000**	**£000**	£000	£000	£000
Financial assets						
- Fair value through income	**313,652**	**948,566**	**1,262,218**	950,277	-	950,277
- Derivative financial instruments	**1,435**	**-**	**1,435**	-	-	-
Loans and other receivables	**25,175**	**-**	**25,175**	24,010	-	24,010
Insurance receivables	**183,828**	**-**	**183,828**	170,439	-	170,439
Reinsurers' share of claims outstanding	**1,691**	**37,892**	**39,583**	11	27,857	27,868
Accrued interest	**19,530**	**-**	**19,530**	3,907	-	3,907
Cash and cash equivalents	**113,759**	**-**	**113,759**	194,136	-	194,136
Total assets	**659,070**	**986,458**	**1,645,528**	1,342,780	27,857	1,370,637

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

The table below summarises the estimated maturity profile of the financial liabilities of the company based on remaining undiscounted obligations.

	Within 1 year	**1-3 years**	**3-5 years**	**Over 5 years**	**No term**	**Total**
Maturity profile of financial liabilities 2012	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Insurance contract liabilities	**311,239**	**327,380**	**106,438**	**41,134**	**-**	**786,191**
Insurance payables	**10,081**	**-**	**-**	**-**	**-**	**10,081**
Trade and other payables	**75,375**	**-**	**-**	**-**	**-**	**75,375**
	396,695	**327,380**	**106,438**	**41,134**	**-**	**871,647**

	Within 1 year	1-3 years	3-5 years	Over 5 years	No term	Total
Maturity profile of financial liabilities 2011	£000	£000	£000	£000	£000	£000
Insurance contract liabilities	272,982	198,847	80,536	20,504	-	572,869
Insurance payables	8,669	-	-	-	-	8,669
Trade and other payables	70,086	-	-	-	-	70,086
	351,737	198,847	80,536	20,504	-	651,624

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).

Specific valuation techniques used to value financial instruments include:

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

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

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

		2012				2011	
	Level 1	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Total
31 December	**£000**	**£000**	**£000**	**£000**	£000	£000	£000
Fair value through income							
Shares, other variable yield securities and units in unit trusts	**151,755**	**85,437**	**-**	**237,192**	34,385	915,892	950,277
Debt and other fixed income securities	**108,108**	**916,918**	**-**	**1,025,026**	-	-	-
Derivative financial instruments	**771**	**-**	**664**	**1,435**	-	-	-
Total	**260,634**	**1,002,355**	**664**	**1,263,653**	34,385	915,892	950,277

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

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

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

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 £664,000 (2011: £nil).

	2012	2011
Derivative financial instruments	**£000**	£000
Total gain recorded in comprehensive income	664	-
Balance at 31 December	**664**	-

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

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

Strategic risk

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

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

Group risk

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

The Company has not identified any significant Group risks.

Operational risk

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

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

6. Net premium revenue

	2012 **£000**	2011 £000
Insurance contracts:		
Premiums written	**1,152,896**	1,060,774
Change in unearned premium reserve	**(25,874)**	(125,951)
Premium revenue arising from insurance contracts issued	**1,127,022**	934,823
Reinsurance contracts:		
Premiums payable	**(28,832)**	(22,450)
Change in unearned premium reserve	**1,706**	2,828
Premium revenue ceded to reinsurers on insurance contracts issued	**(27,126)**	(19,622)
Net premium revenue	**1,099,896**	915,201
Motor	**835,395**	701,109
Property	**125,375**	114,779
Commercial	**77,206**	49,065
Other	**61,920**	50,248
	1,099,896	915,201

Other premium receivable includes travel, legal and pet insurance.

7. Investment income

	2012	2011
	£000	£000
Income from investments and cash and cash equivalents		
-Interest income	**32,964**	3,344
-Dividend income	**15,353**	26,026
	48,317	29,370

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

	2012	2011
	£000	£000
Gains/(losses) on financial assets at fair value through income		
-Debt securities	**15,838**	(892)
-Equity securities	**12,978**	(530)
-Derivative financial instruments	**(3,461)**	716
	25,355	(706)

Net fair value gains on financial assets held at fair value through income include net realised gains of £9,137,000 (2011: £4,005,000 gains) and net unrealised gains of £16,218,000 (2011: £4,711,000 losses)

9. Other income

	2012	2011
	£000	£000
Interest income	**22,033**	17,390
Other income	**10,273**	10,263
	32,306	27,653

Other income is primarily comprised of fee and commission income.

10. Insurance claims and loss adjustment expenses

	2012 £000	2011 £000
Gross insurance claims		
Claims paid during the year	**604,397**	521,733
Claims management costs	**41,873**	30,621
Movement in claims liabilities	**213,322**	125,764
	859,592	678,118
Reinsurers' share of gross insurance claims		
Current year claims and loss adjustment expenses	**(7,443)**	(627)
Movement in reinsurer's share of claims liabilities	**(11,715)**	(9,741)
	(19,158)	(10,368)
Net insurance claims	**840,434**	667,750

Included within claims incurred is an increase of £21.4m in respect of motor insurance business (2011: £11.9m increase) and a release of £5.4m in respect of property insurance business (2011: £9.8m release), 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. Other operating and administrative expenses

	2012 £000	2011 £000
Investment management expenses and charges	**1,700**	1,338
Acquisition expenses	**145,630**	126,967
Movement in deferred acquisition expenses	**(7,171)**	(9,688)
Auditors' remuneration	**203**	170
Amortisation of intangibles	**180**	180
Impairment of insurance receivables	**1,132**	567
Administrative expenses	**138,016**	135,177
	279,690	254,711

12. Auditors' remuneration

	2012 £000	2011 £000
Audit of company	**182**	150
Audit related assurance services	**21**	20
	203	170

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

13. Directors' emoluments

All directors are remunerated by LVFS or LVIM.

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

The aggregate amount of Directors' emoluments was as follows:

	2012	2011
	£000	£000
a) Aggregate emoluments	**6,589**	5,486

b) There were £70,000 of contributions to the defined contribution pension scheme (2011: £70,000).

c) Emoluments of the Directors were as follows:

	Salary	**Bonus**	**Deferred Bonus***	**Other Benefits**	**Long Term Incentive Plan**	**2012 Total**	2011 Total
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	£000
Highest paid Director	**505**	**427**	**132**	**127**	**1,431**	**2,622**	2,178
All Directors	**2,401**	**1,509**	**184**	**214**	**2,280**	**6,589**	5,486

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

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

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

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

LVFS makes contributions to the LV= Employee Pension Scheme of 17.8% of pensionable salaries (2011: 17.1% of pensionable salaries) subject to annual allowance limits, in respect of all permanent staff, including executive directors. This included amounts on behalf of executive directors of £99,485 (2011: £147,000).

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

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

	2012	2011
Accrued pension at end of the year	**£000**	£000
All Directors	**134**	146

14. Income tax expense

a) Current year tax expense

	2012 £000	2011 £000
Current year tax expense:		
Corporation tax	**16,434**	1,434
Group relief	**3,919**	3,288
Adjustment to current tax in respect of prior years	**38**	-
Total current tax	**20,391**	4,722
Deferred tax		
Adjustment to deferred tax in respect of prior years	**-**	(1,920)
Temporary differences	**107**	7,597
Total deferred tax	**107**	5,677
Total income tax expense	**20,498**	10,399

b) Reconciliation of tax expense

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

	2012 £000	2011 £000
Profit before tax	**85,750**	49,057
Profit multiplied by standard rate of corporation tax in the UK of 24.5% (2011: 26.5%)	**21,009**	13,000
Effects of:		
Impact of change in UK corporation tax rate on deferred tax	**(55)**	97
Adjustment to current tax in respect of prior years	**38**	-
Adjustment to deferred tax in respect of prior years	**-**	(1,920)
Income not subject to Corporation Tax	**(494)**	(778)
Total income tax expense for the year	**20,498**	10,399

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

15. Investments in group undertakings

	2012 £000	2011 £000
At 1 January	**301,012**	301,012
Balance at 31 December	**301,012**	301,012

15. Investments in group undertakings (continued)

Name	Incorporated and domiciled	Principal activity	Percentage of shares held	Type of shares held
Highway Insurance Group Limited	England and Wales	General insurance holding company	100% directly held	Ordinary
Highway Insurance Company Limited	England and Wales	General Insurance	100% indirectly held	Ordinary

16. Intangible assets

	Goodwill £000	Other £000	Total £000
Cost			
At 1 January 2012	15,812	3,375	**19,187**
At 31 December 2012	15,812	3,375	**19,187**
Accumulated amortisation			
At 1 January 2012	-	(675)	**(675)**
Amortisation charge for the year	-	(180)	**(180)**
At 31 December 2012	-	(855)	**(855)**
Net book value at 31 December 2012	**15,812**	**2,520**	**18,332**
Net book value at 31 December 2011	15,812	2,700	18,512

The Company does not carry out an individual impairment review of the goodwill, instead it relies on the cash generating unit assessment carried out by LVGIG Group. The full disclosure of this assessment is included in the LVGIG Group consolidated accounts. There is currently no indication that impairment is required.

Amortisation and impairment losses are presented in other operating and administrative expenses in the Statement of comprehensive income.

Other intangibles primarily comprises customer books recognised on acquisitions.

17. Deferred acquisition costs

	2012 £000	2011 £000
At 1 January	**66,069**	56,381
Acquisition expenses deferred	**145,630**	126,967
Amortisation	**(138,459)**	(117,279)
At 31 December	**73,240**	66,069

18. Financial assets

	2012 £000	2011 £000
Fair value through income		
Shares, other variable yield securities and units in unit trusts	**237,192**	950,277
Debt and other fixed income securities	**1,025,026**	-
	1,262,218	950,277

19. Derivative financial instruments

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

	2012			2011		
	£000	**£000**	**£000**	£000	£000	£000
	Contract/ notional amount	**Fair value - asset**	**Fair value - liability**	Contract/ notional amount	Fair value - asset	Fair value - liability
Futures (FTSE 100)	**49,777**	**771**	**-**	-	-	-
Contracts for differences (gilt hedge)	**914,000**	**664**	**-**	-	-	-
	963,777	**1,435**	**-**	-	-	-

As a result of the use of the above derivative instruments, a significant proportion of the Company's asset portfolio was hedged against the stock market and gilt yield movements

20. Loans and other receivables

	2012 £000	2011 £000
Amounts due from group undertakings	**22,450**	22,450
Other receivables	**2,725**	1,560
	25,175	24,010

21. Insurance receivables

	2012 £000	2011 £000
Receivables arising from insurance and reinsurance contracts:		
Due from policyholders	**147,123**	131,226
Due from agents, brokers and intermediaries	**36,700**	39,209
Due from reinsurers	**5**	4
	183,828	170,439

As at 31 December 2012 overdue insurance receivables arising from insurance contracts were provided at £456,000 (2011: £316,000).

22. Reinsurance assets

	2012 £000	2011 £000
Reinsurers' share of provision for unearned premiums	**14,713**	13,007
Reinsurers' share of claims outstanding	**39,583**	27,868
	54,296	40,875

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

23. Prepayments and accrued income

	2012 £000	2011 £000
Accrued interest	**19,530**	3,907
Prepayments	**517**	-
	20,047	3,907

Accrued interest includes £17,227,000 (2011: £2,094,000) of interest relating to fixed income securities.

24. Cash and cash equivalents

	2012 £000	2011 £000
Bank balances	**(4,539)**	7,624
Short term bank deposits	**118,298**	186,512
Cash and cash equivalents	**113,759**	194,136

25. Insurance contract liabilities

a) Analysis of insurance contract liabilities

	2012			2011		
	Gross	**Reinsurance**	**Net**	Gross	Reinsurance	Net
	£000	**£000**	**£000**	£000	£000	£000
General insurance claims liabilities	**786,191**	**(39,583)**	**746,608**	572,869	(27,868)	545,001
General insurance unearned premiums	**580,765**	**(14,713)**	**566,052**	554,891	(13,007)	541,884
	1,366,956	**(54,296)**	**1,312,660**	1,127,760	(40,875)	1,086,885

b) Movement in general insurance claims liabilities

	2012			2011		
	Gross	**Reinsurance**	**Net**	Gross	Reinsurance	Net
	£000	**£000**	**£000**	£000	£000	£000
OCR	**567,921**	**(12,748)**	**555,173**	438,183	(13,256)	424,927
IBNR	**4,948**	**(15,120)**	**(10,172)**	8,922	(4,871)	4,051
Balance at 1 January	**572,869**	**(27,868)**	**545,001**	447,105	(18,127)	428,978
Movement in claims incurred in prior accident years	**15,398**	**(7,927)**	**7,471**	17,194	(4,347)	12,847
Claims incurred in the current accident year	**802,321**	**(11,231)**	**791,090**	630,303	(6,021)	624,282
Claims paid during the year	**(604,397)**	**7,443**	**(596,954)**	(521,733)	627	(521,106)
	213,322	**(11,715)**	**201,607**	125,764	(9,741)	116,023
Balance at 31 December	**786,191**	**(39,583)**	**746,608**	572,869	(27,868)	545,001
OCR	**766,095**	**(20,965)**	**745,130**	567,921	(12,748)	555,173
IBNR	**20,096**	**(18,618)**	**1,478**	4,948	(15,120)	(10,172)
Balance at 31 December	**786,191**	**(39,583)**	**746,608**	572,869	(27,868)	545,001

c) Movement in general insurance unearned premiums

	2012			2011		
	Gross	**Reinsurance**	**Net**	Gross	Reinsurance	Net
	£000	**£000**	**£000**	£000	£000	£000
Balance at 1 January	**554,891**	**(13,007)**	**541,884**	428,940	(10,179)	418,761
Premiums written in the year	**1,152,896**	**(28,832)**	**1,124,064**	1,060,774	(22,450)	1,038,324
Premiums earned during the year	**(1,127,022)**	**27,126**	**(1,099,896)**	(934,823)	19,622	(915,201)
Balance at 31 December	**580,765**	**(14,713)**	**566,052**	554,891	(13,007)	541,884

25. Insurance contract liabilities (continued)

Details of the methodologies used for the premium and claims provisions for motor and household products are provided below.

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 generated each month-end by a system driven calculation. 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 for motor products are:

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

The claim types modelled for household products are:

- Accidental Damage (Buildings and Contents separately)
- Escape Of Water (Buildings and Contents separately)
- Fire (Buildings and Contents separately)
- Theft (Buildings and Contents separately)
- Weather (Buildings and Contents separately)
- Subsidence (Buildings only)
- Freezer Failure (Contents only)
- Personal Possessions
- Caravans

Unearned Premium Reserve ('UPR')

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

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26. Insurance payables

	2012	2011
	£000	£000
Due to reinsurers	**10,063**	8,661
Due to policy holders	**-**	1
Due to intermediaries	**18**	7
	10,081	8,669

27. Deferred tax liability

	2012	2011
	£000	£000
At 1 January	**556**	(5,121)
Current year charge	**107**	5,677
At 31 December	**663**	556

Analysis of deferred taxation temporary differences:

	£000	£000
Accelerated capital allowances	**(27)**	(36)
Temporary differences on expenses	**690**	592
	663	556

Analysis of the deferred tax balance

	£000	£000
Deferred tax liability expected to be recovered after more than 12 months	**640**	563
Deferred tax asset expected to be recovered within 12 months	**23**	(7)
	663	556

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

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

28. Current tax liability

	2012	2011
	£000	£000
At 1 January	**1,434**	-
Amounts recorded in the Statement of comprehensive income	**20,391**	1,434
Payments made in respect of group relief	**(1,472)**	-
Income tax paid	**(8,570)**	-
At 31 December	**11,783**	1,434

29. Trade and other payables

	2012	2011
	£000	£000
Amounts owed to group undertakings	**38,062**	36,252
Accruals and deferred income	**12,275**	11,570
Other taxes and social security costs	**16,357**	16,239
Trade payables	**-**	161
Other payables	**8,681**	5,864
	75,375	70,086

30. Share capital

	2012	2011
	£000	£000
Ordinary shares, allotted and fully paid		
344,907,680 (2011: 344,907,680) ordinary shares of £1 each	**344,908**	344,908

31. Capital reserve

	2012	2011
	£000	£000
Balance at 1 January	**278,044**	274,044
Dividends paid	**(37,500)**	-
Capital contributions	**-**	4,000
Balance at 31 December	**240,544**	278,044

The Company received the following capital contributions from LVGIG during 2011:

	2011
	£000
26 January 2011	4,000
Total contribution for the year	4,000

The Company paid the following interim dividends to LVGIG during 2012:

	2012
	£000
13 December 2012	13,000
19 December 2012	15,000
27 December 2012	9,500
Total dividends paid for the year	**37,500**

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

32. Retained earnings/(accumulated losses)

	2012	2011
	£000	£000
Balance at 1 January	**(62,220)**	(100,878)
Profit for the year	**65,252**	38,658
Balance at 31 December	**3,032**	(62,220)

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

	2012 £000	Restated (see note 2) 2011 £000
Profit before tax	**85,750**	49,057
Investment income	**(48,317)**	(29,370)
Interest income received	**(22,033)**	(17,390)
(Gains)/losses on financial assets recorded in the statement of comprehensive income	**(25,355)**	706
Net purchases of investments at fair value through income	**(283,125)**	(155,155)
(Purchase)/sales of financial derivatives	**(4,896)**	660
Non cash items		
Expenses deferred during the year	**(7,171)**	(9,688)
Amortisation of intangible assets	**180**	180
Changes in working capital		
(Increase)/decrease in loans and other receivables	**(1,165)**	2,586
Increase in reinsurance assets	**(13,421)**	(12,569)
Increase in insurance receivables	**(13,389)**	(36,158)
(Increase)/decrease in other prepayments and accrued income	**(517)**	589
Increase in insurance contract liabilities	**239,196**	251,715
Increase in insurance payables	**1,412**	425
Increase in trade and other payables	**5,289**	43,011
Cash (used in)/generated from operating activities	**(87,562)**	88,599

34. Related party transactions

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

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

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

	2012	2011
	£000	£000
Short-term employee benefits	**4,309**	3,693
Post-employment benefits	**146**	216
Other long-term benefits	**2,280**	1,673
Termination benefits	**-**	120
	6,735	5,702

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

	2012	2011
	£000	£000
Management charge to the Company	**219,285**	198,097
	219,285	198,097

The following transactions have taken place between the Company and Liverpool Victoria General Insurance Group Limited:

	2012	2011
	£000	£000
Capital contribution from Liverpool Victoria General Insurance Group Limited	**-**	4,000
Dividend to Liverpool Victoria General Insurance Group Limited	**(37,500)**	-
	(37,500)	4,000

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

	2012	2011
	£000	£000
Payable by the Company to Liverpool Victoria Friendly Society Limited	**(38,062)**	(36,252)
Payable to the Company by Highway Insurance Group Limited	**22,450**	22,450
	(15,612)	(13,802)

35. Ultimate parent company

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

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

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

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

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

The consolidated accounts of Liverpool Victoria Friendly Society Limited are available to the public and may be obtained from:
The Company Secretary
County Gates
Bournemouth
BH1 2NF

or at www.lv.com/aboutus/report