LLOYDS TSB GENERAL INSURANCE LIMITED

REPORT AND ACCOUNTS FOR YEAR ENDED 31 DECEMBER 2011

Registered Number:
204373

Registered Office:

25 Gresham Street,
London,
EC2V 7HN

Directors:

Dr N M Bryson (Interim Chairman)
R J M Bulloch (Managing Director)
K P Cracknell
G N Stewart
T E Strauss
D J Walkden
M Christophers (Non-executive Director)
J Goford (Non-executive Director)
A M Peck (Non-executive Director)

Company Secretary

S Mayer

Member of Lloyds Banking Group

LLOYDS TSB GENERAL INSURANCE LIMITED

Registered number 204373

DIRECTORS' REPORT

Lloyds TSB General Insurance Limited ('the Company") is a company limited by shares, domiciled and incorporated in the United Kingdom The Company's principal place of business is Tredegar Park, Newport, South Wales, NP10 8SB

Principal activity and business review

The principal activity of the Company is underwriting general insurance, including creditor insurance and household and domestic all risks insurance In September 2011 the brand coverage was extended to include new business written by the Halifax and Bank of Scotland brands as well as the existing Lloyds TSB brand Policies are sold through the Lloyds Banking Group distribution channels and corporate partnerships

On the 8th February 2011 the Company announced a reduction in workforce following the decision made by Lloyds Banking Group plc, in July 2010, to cease selling Payment Protection Insurance The Company is focussing on determining the best model to provide ongoing support to the existing customer base

The principal risks and uncertainties facing the business are considered to be Insurance Risk, Operational Risk, Credit Risk, Liquidity Risk and Market Risk (see Note 4 to the financial statements) These risks continue to be closely managed during these times of uncertainty

Profit before tax grew by £43m (33%), mainly reflecting improved performance on property, with 2011 being relatively benign, whereas 2010 was impacted by two freeze events This is partly offset by the run-off of the creditor book and increased expenses The creditor run-off has resulted in lower premium revenue, partly offset by lower claims incurred and commission payments

The business strategy and focus for 2012 and beyond, for the Insurance Division, continues to be profitably growing market share in chosen segments, developing profitable insurance partnerships, improving margins through better customer management, improving service and efficiency, successfully embedding Solvency II and creating one Insurance business (bringing the General Insurance and the Life, Pensions and Investment businesses together)

Results and dividends

The profit after taxation for the year ended 31 December 2011 amounted to £130m as set out in the statement of comprehensive income on page 8 (2010 £95m)

Interim dividends of £132m (£2 14 per share) were paid during the year in respect of 2011

Interim dividends of £119m (£1 93 per share) were paid during 2010 in respect of 2010

The directors do not recommend any further dividend in respect of 2011

Key Performance Indicators ('KPIs')

The Company's financial KPIs are net insurance premium revenue, claims and loss adjustment expenses and employee numbers all of which are disclosed in the financial statements, together with the Company's combined ratio The Company's decreased combined ratio of 71% (2010 81%) reflects decreased claims costs on the property book following benign weather in 2011 compared to freeze events during 2010

Directors

The names of the present directors of the Company are shown on page 1

The following changes in directors have taken place during the year and following the financial year end

	Appointed	Resigned
A D Briggs		20 May 2011
A G Kane		20 May 2011
S J Hughes		11 October 2011
R A M V Delm		14 October 2011
M Canniffe		31 December 2011
L K Forster		31 December 2011
M Christophers	24 January 2011	
R L Beaven	2 February 2011	31 December 2011
I C R Stuart	16 March 2011	31 December2011
R J M Bulloch	20 May 2011	
R Harris	20 May 2011	29 February 2012
T E Strauss	17 October 2011	
K P Cracknell	24 October 2011	
G N Stewart	1 January 2012	
Dr N M Bryson	24 January 2012	
J Goford	24 January 2012	
A M Peck	24 January 2012	
D J Walkden	24 January 2012	

All directors have the benefit of a contract of indemnity, which is both a Qualifying Third Party Indemnity Provision and a Qualifying Pension Scheme Indemnity Provision This was in force during the whole of the year Directors no longer in office but who served on the Board at any time in the year had the benefit of this contract of indemnity during that period of service

Policy and practice on payment of creditors

The Company complies with the 'Prompt Payment Code' published by the Department for Business Innovation and Skills ('BIS'), regarding the making of payments to suppliers Information about the 'Prompt Payment Code' may be obtained by visiting www promptpaymentcode org uk

The Company's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of invoice, except where other arrangements have been negotiated It is the policy of the Company to abide by the agreed terms of payment, provided the supplier performs according to the terms of the contract

As the Company owed no amounts to trade creditors at 31 December 2011, the number of days required to be shown in this report, to comply with the provisions of the Companies Act 2006, is nil (2010 nil)

Employees

The Company, as part of Lloyds Banking Group, is committed to providing employment practices and policies which recognise the diversity of our workforce and ensure equality for employees regardless of sex, race, disability, age, sexual orientation or religious belief

In the UK, Lloyds Banking Group belongs to the major employer groups campaigning for equality for the above groups of staff, including Employers' Forum on Disability, Employers' Forum on Age, Stonewall and the Race for Opportunity Our involvement with these organisations enables us to identify and implement best practice for our staff

Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys There are well established procedures, including regular meetings with recognised unions, to ensure that the views of employees are taken into account in reaching decisions

Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in Lloyds Banking Group plc

Lloyds Banking Group is committed to providing employees with comprehensive coverage of the economic and financial issues affecting the Group We have established a full suite of communication channels, including an extensive face-to-face briefing programme which allows us to update our employees on our performance and any financial issues throughout the year

Statement of directors' responsibilities

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

Company law requires the directors to prepare financial statements for each financial year Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union In preparing these financial statements, the directors have also elected to comply with IFRSs, issued by the International Accounting Standards Board (IASB) 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 In preparing these financial statements, the directors have also elected to comply with IFRSs, issued by the International Accounting Standards Board (IASB),
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business

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

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

Risk

The Company s exposure to financial risk relates to insurance, market, credit and liquidity risks The Company is also exposed to operational risk The directors believe that there are proper procedures and controls in place, as explained in Note 4 in more detail, to enable the Company to minimise these risks

Charitable and Political Donations

The Company has not made any charitable or political donations during the year (2010 nil)

LLOYDS TSB GENERAL INSURANCE LIMITED

Registered number 204373

DIRECTORS' REPORT (continued)

Statement of disclosure of information to auditors

In so far as each director in office at the date that the directors' report is approved is aware, there is no relevant audit information of which the Company's auditors are unaware, and each director has taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information

On behalf of the board

K P Cracknell
Director
29 March 2012

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LLOYDS TSB GENERAL INSURANCE LIMITED

We have audited the financial statements of Lloyds TSB General Insurance Limited for the year ended 31 December 2011 which comprise the Balance Sheet, the Statement of Comprehensive Income, the Statement of Cash Flow, the Statement of Changes in Equity, the Accounting Policies and the related notes The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union

Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' Responsibilities (set out on page 4), the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the company's affairs as at 31 December 2011 and of its profit and cash flows for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

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

David Roper (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester
29 March 2012

LLOYDS TSB GENERAL INSURANCE LIMITED

Registered number 204373

BALANCE SHEET

AS AT 31 DECEMBER 2011
(All amounts in £ thousands unless otherwise stated)

	Note	2011	2010
ASSETS			
Intangible insurance assets	5	70,614	83,909
Financial assets held at fair value through income			
Collective Investment Schemes	6,7	334,781	405,530
Debt securities	6,7	50,998	85,004
Loans and receivables including insurance receivables	7,8	337,999	350,476
Reinsurance assets	9,13	13,821	12,102
Cash and cash equivalents	6,7,10	53,068	49,117
Total assets		861,281	986,138
EQUITY AND LIABILITIES			
Equity attributable to the Company's equity holder			
Ordinary share capital	11	61,700	61,700
Retained earnings	12	197,989	199,858
Total equity		259,689	261,558
LIABILITIES			
Insurance contracts	13	452,584	565,791
Provisions for other liabilities and charges	14	2,578	1,187
Trade and other payables	15	79,773	99,978
Deferred income tax	16	21,436	22,410
Income tax liability	29	45,221	35,214
Total liabilities		601,592	724,580
Total equity and liabilities		861,281	986,138

The notes on pages 11 to 49 form an integral part of these financial statements

The financial statements were approved by the Board of Directors on 29 March 2012 and were signed on its behalf by

KP Cracknell

K P Cracknell
Director

LLOYDS TSB GENERAL INSURANCE LIMITED

Registered number 204373

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2011
(All amounts in £ thousands unless otherwise stated)

	Note	2011	2010
Insurance contract premium revenue	18	586,786	676,277
Insurance contract premium ceded to reinsurers	18	(25,594)	(21,642)
Net premium revenue	18	561,192	654,635
Investment income	19	4,568	5,139
Net fair value gains on financial assets held at fair value through income	20	6,067	4,868
Total income		571,827	664,642
Insurance claims and loss adjustment expenses	21	(143,146)	(256,823)
Insurance claims and loss adjustment expenses recoverable from reinsurers	21	1	(828)
Net insurance claims		(143,145)	(257,651)
Expenses for the acquisition of insurance contracts	22	(197,090)	(225,167)
Expenses for marketing and administration	22	(57,214)	(50,878)
Total expenses		(397,449)	(533,696)
Results of operating activities and profit before income tax		174,378	130,946
Income tax expense	24	(44,247)	(35,986)
Profit for the year attributable to equity holder of the Company		130,131	94,960
Other comprehensive income for the year		-	-
Total comprehensive income for the year attributable to equity holder of the Company		130,131	94,960

All the amounts above are in respect of continuing operations

The notes on pages 11 to 49 form an integral part of these financial statements

LLOYDS TSB GENERAL INSURANCE LIMITED

Registered number 204373

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2011
(All amounts in £ thousands unless otherwise stated)

		Attributable to the equity holder of the Company		
	Note	**Share capital**	**Retained earnings**	**Total equity**
Year ended 31 December 2010				
At beginning of year		61,700	223,898	285,598
Comprehensive income for the year and total recognised income for 2010		-	94,960	94,960
Dividends paid	25	-	(119,000)	(119,000)
At end of year	11, 12	61,700	199,858	261,558
Year ended 31 December 2011				
At beginning of year		61,700	199,858	261,558
Comprehensive income for the year and total recognised income for 2011		-	130,131	130,131
Dividends paid	25	-	(132,000)	(132,000)
At end of year	11, 12	61,700	197,989	259,689

All retained earnings are distributable except as disclosed in Note 12

The notes on pages 11 to 49 form an integral part of these financial statements

LLOYDS TSB GENERAL INSURANCE LIMITED

Registered number 204373

STATEMENT OF CASH FLOW

FOR THE YEAR ENDED 31 DECEMBER 2011
(All amounts in £ thousands unless otherwise stated)

	Note	2011	2010
Cash flows from operating activities			
Cash generated by operations	26	55,775	60,332
Income tax paid		(35,214)	(39,884)
Net cash generated by operating activities		20,561	20,448
Cash flows from investing activities			
Net disposal/(addition) of collective investment schemes, equity and debt securities		108,926	(407,443)
Interest received		4,541	5,138
Dividend and other income received		1,896	2,960
Net cash generated /(used) by investing activities		115,363	(399,345)
Cash flows from financing activities			
Dividends paid to company equity holder		(132,000)	(119,000)
Net cash used by financing activities		(132,000)	(119,000)
Net increase/(decrease) in cash and cash equivalents		3,924	(497,897)
Cash and cash equivalents at beginning of year	10	49,092	546,989
Cash and cash equivalents at end of year	10	53,016	49,092

The notes on pages 11 to 49 form an integral part of these financial statements

1 General information

Lloyds TSB General Insurance Limited underwrites general insurance risks, including household and domestic all risks insurance, creditor insurance and accident and health insurance marketed primarily under the Lloyds TSB brand and sold predominantly through the Lloyds Banking Group ('Group') and corporate partnerships All contracts of insurance are written in the United Kingdom

2 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below These policies have been consistently applied to all the years presented, unless otherwise stated

2 1 Basis of presentation

These financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as defined by IAS 1 They have been prepared under the historical cost convention, as modified by the revaluation of land and buildings, investment property, available-for-sale financial assets, and financial assets and financial liabilities (including derivative instruments) at fair value through income

The preparation of financial statements 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 financial statements, are disclosed in Note 3

All amounts in the notes are rounded to the nearest thousand, unless otherwise stated

2 1 1 Changes in accounting policy and disclosures

(a) 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 or after 1 January 2011 that would be expected to have a material impact on the Company

(b) New standards, amendments and interpretations issued but not effective for the financial year beginning 1 January 2011 and not early adopted

- Amendments to IFRS 7, 'Financial instruments Disclosures' on transfers of financial assets, promote transparency in the reporting of transfer transactions and improves users' understanding of the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitisation of financial assets The Company is yet to assess the full impact of the amendments and intends to adopt IFRS 7 no later than the accounting period beginning on or after 1 January 2012

- 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 2013

2 **Summary of significant accounting policies (continued)**

2 1 1 **Changes in accounting policy and disclosures (continued)**

(b) New standards, amendments and interpretations issued but not effective for the financial year beginning 1 January 2011 and not early adopted (continued)

- IFRS 10, 'Consolidated financial statements', builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company The standard provides additional guidance to assist in the determination of control where this is difficult to assess The Company is yet to assess IFRS 10's full impact and intends to adopt IFRS 10 no later than the accounting period beginning on or after 1 January 2013

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

- IFRS 12, '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

- 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 The Company is yet to assess IFRS 13's full impact and intends to adopt IFRS 13 no later than the accounting period beginning on or after 1 January 2013

- Amendment to IAS 12, 'Income taxes', on deferred tax currently requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale It can be difficult and subjective to assess whether recovery will be through use or through sale when the asset is measured using the fair value model in IAS 40, 'Investment property' This amendment therefore introduces an exception to the existing principle for the measurement of deferred tax assets or liabilities arising on investment property measured at fair value As a result of the amendments, SIC 21, 'Income taxes - recovery of revalued non-depreciable assets', will no longer apply to investment properties carried at fair value The amendments also incorporate into IAS 12 the remaining guidance previously contained in SIC 21, which is withdrawn The Company is yet to assess IAS 12 s full impact and intends to adopt IAS 12 no later than the accounting period beginning on or after 1 January 2012

- IAS 19, 'Employee benefits', was amended in June 2011 The impact on the Company will be as follows to eliminate the corridor approach and recognise all actuarial gains and losses in OCI as they occur, to immediately recognise all past service costs, and to replace interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit liability (asset) The Company is yet to assess the full impact of the amendments and intends to adopt IAS 12 no later than the accounting period beginning on or after 1 January 2013

2 **Summary of significant accounting policies (continued)**

2 1 **Changes in accounting policy and disclosures (continued)**

(c) Measurement bases used in the preparation of the financial statements

The financial statements are presented in Sterling, rounded to the nearest thousand They are prepared on the historical cost basis

Non-current assets are stated at the lower of carrying amount and fair value less costs to sell

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources Actual results may differ from these estimates

The estimates and underlying assumptions are reviewed on an ongoing basis Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods

Consolidation of subsidiaries has not been undertaken as the Company forms part of Lloyds Banking Group, which prepares a group set of consolidated financial statements under IFRS

2 2 **Segment reporting**

As a non-publicly traded company (wholly-owned by Lloyds Banking Group plc), the Company has chosen not to disclose segmental information

2 Summary of significant accounting policies (continued)

2 3 Financial assets

The Company classifies its financial assets into the following categories financial assets at fair value through income and loans and receivables The classification depends on the purpose for which the financial assets were acquired Management determines the classification of its financial assets at initial recognition

(a) Financial assets at fair value through income

The Company designates all its equity and debt securities, including collective investment schemes, at fair value through profit and loss on inception

Financial assets designated as at fair value through income at inception are those that are managed and whose performance is evaluated on a fair value basis Information about these financial assets is provided internally on a fair value basis to the Company's key management personnel The Company's investment strategy is to invest in equity and debt securities, and to evaluate them with reference to their fair values Assets that are part of these portfolios are designated upon initial recognition at fair value through profit or loss (see Note 4 3 for additional details on the Company's portfolio structure)

Regular purchases and sales of financial assets are recognised on the trade-date, the date on which the Company commits to purchase or sell the asset Financial assets carried at fair value through income are initially recognised at fair value and transaction costs are expensed in the statement of comprehensive income Financial assets are derecognised when the right to receive cash flows from the investments has expired or has been transferred and the Company has transferred substantially all risks and rewards of ownership

The fair values of listed investments in an active market are based on current bid prices The fair values of unlisted collective investment schemes are determined by using the mark to market values of the individual underlying holdings of the schemes If the market for a financial asset is not active, the fund manager establishes fair value by using valuation techniques These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and option pricing models

(b) Loan and receivables

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market Loans and receivables are included in Insurance and other receivables on the balance sheet and are reviewed for impairment as part of the impairment review

2 **Summary of significant accounting policies (continued)**

2 4 **Impairment of assets**

(a) Financial assets carried at amortised cost

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

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

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

(iii) it becoming probable that the issuer or debtor will enter bankruptcy or other financial reorganisation,

(iv) the disappearance of an active market for that financial asset, or

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

- adverse changes in the payment status of issuers or debtors in the group, or
- national or local economic conditions that correlate with defaults on the assets in the group

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

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

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

(b) Non-Financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount The recoverable amount is the higher of an asset s fair value less costs to sell and value in use For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows

2 **Summary of significant accounting policies (continued)**

2 5 **Cash and cash equivalents**

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, bank overdrafts where there is a right of offset and accrued interest

2 6 **Share capital**

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

2 7 **Insurance contracts**

The Company issues insurance contracts Insurance contracts are those that transfer significant insurance risk As a general guideline, the Company defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event which are more than 10% of the benefits payable if the insured event were not to occur

(a) Recognition and measurement

All of the insurance contracts issued by the Company are short-term contracts categorised as household and domestic all risks, creditor or accident and health

Household and domestic all risks insurance contracts mainly compensate the Company s customers for damage suffered to their properties and their contents

Creditor contracts mainly compensate the Company's customers against the cost to the insured of sustaining injury, suffering sickness or infirmity, suffering loss of income due to causes that may or may not be specified in the contract, where the benefits payable under the contract relate to loans, credit card balances or other debts (excluding mortgage indemnity)

Accident and health insurance contracts mainly compensate the Company's customers with fixed pecuniary benefits against costs of the insured requiring health care for sickness, infirmity or injuries sustained Accident and health insurance risks are not considered to be a material part of the Company s insurance business

For all of these contracts, premiums are recognised as revenue proportionally over the period of coverage Written premiums, gross of commission payable to intermediaries, comprise the premiums on contracts entered into in a financial year, regardless of whether such amounts may relate in whole or in part to a later financial year, exclusive of insurance premium tax and duties levied on premiums The amount of insurance premium tax due by the Company which has not been paid over to Customs & Excise as at the balance sheet date is included as a liability under the heading 'Trade and other creditors" The portion of premium received on in-force contracts that relates to unexpired risks at the balance sheet date is reported as the unearned premiums liability

Premiums written include adjustments for any differences between unearned premiums recorded in prior years and amounts ultimately received Outward reinsurance premiums are accounted for in the same accounting period as the premiums for the inwards insurance business

Premiums collected by intermediaries, but not yet received, are assessed based on estimates from underwriting or past experience, and are included in premiums written

2 **Summary of significant accounting policies (continued)**

2 7 **Insurance contracts (continued)**

Claims and loss adjustment expenses are charged to the statement of comprehensive income as incurred based on the estimated liability for compensation owed to contract holders or third parties damaged by the contract holders They include direct and indirect claims settlement costs and arise from events that have occurred up to the balance sheet date even if they have not yet been reported to the Company

The Company does not discount its liabilities for unpaid claims

The provision for outstanding claims represents the ultimate cost of settling all claims, including direct and indirect claims settlement costs, arising from events that have occurred up to the balance sheet date This provision comprises an amount for the cost of claims notified but not settled and for claims incurred but not yet reported

The provision for claims incurred but not reported at the date of the balance sheet and the related claims settlement expenses together with the anticipated reinsurance and other recoveries, is made on the basis of the best information currently available, having regard, in particular, to past claims experience Subsequent information and events may result in the ultimate liabilities being more than, or less than, the amount provided for the estimated net liabilities at a particular balance sheet date The estimates made are regularly reviewed in the light of subsequent information and any resulting adjustments are reflected in the earnings of the year in which the adjustments are made

(b) Deferred policy acquisition costs (DAC') – Intangible insurance assets

Commissions and other acquisition costs that vary with and are directly related to securing new contracts and renewing existing contracts are capitalised as an intangible asset (DAC), where they can be identified separately and measured reliably and it is probable that they will be recovered All other costs are recognised as expenses when incurred The DAC is subsequently amortised in line with earned premiums

(c) Liability adequacy test

At each balance sheet 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 profit or loss initially by writing off DAC and by subsequently establishing a provision for losses arising from liability adequacy tests Any DAC written off as a result of this test cannot subsequently be reinstated

(d) Reinsurance contracts held

Contracts entered into by the Company with reinsurers under which the Company is compensated for losses on one or more contracts issued by the Company and that meet the classification requirement for insurance contracts above are classified as reinsurance contracts held Insurance contracts entered into by the Company under which the contract holder is another insurer (inwards reinsurance) are included with insurance contracts

The benefits to which the Company is entitled under its reinsurance contracts held are recognised as reinsurance assets These assets consist of short-term balances due from reinsurers as well as longer term receivables that are dependant on the expected claims and benefits arising under the related reinsurance contracts 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

The Company assesses its reinsurance assets for impairment on a quarterly basis If there is objective evidence that the reinsurance asset is impaired, the Company reduces the carrying amount of the reinsurance asset to its recoverable amount and recognises that impairment loss in the statement of comprehensive income for the period The Company gathers the objective evidence that a reinsurance asset is impaired using the same process adopted for loans and receivables The impairment loss is also calculated following the same method used for these financial assets These processes are described in Note 2 4

2 **Summary of significant accounting policies (continued)**

2 7 **Insurance contracts (continued)**

(e) Receivables and payables related to insurance contracts

Receivables and payables are recognised when due Premiums are deemed receivable in full for the whole period of an insurance contract, upon inception These include amounts due to and from agents, brokers and insurance contract holders

If there is objective evidence that the insurance receivable is impaired, the Company reduces the carrying amount of the insurance receivable accordingly and recognises the impairment loss in the statement of comprehensive income The Company gathers the objective evidence that an insurance receivable is impaired using the same process adopted for loans and receivables The impairment loss is also calculated following the same method used for these financial assets These processes are described in Note 2 4

(f) Claims equalisation reserve

An equalisation reserve is held as an undistributable part of retained earnings as required under FSA rules This reserve is not allowed under IFRS and therefore is not included in the Balance sheet as a liability (Note 12)

2 8 **Income taxes, including deferred income taxes**

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date Current income tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements Deferred tax is determined using tax rates that have been enacted or announced by the balance sheet date that are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised, and are not discounted

2 Summary of significant accounting policies (continued)

2 9 Pension and other post-retirement obligations

The Company's ultimate parent company operates a number of group-wide post-retirement benefit schemes for employees including those employees of the Company, including defined benefit and defined contribution pension A defined benefit scheme is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, dependent on one or more factors such as age, years of service and salary A defined contribution plan is a pension plan into which the Group pays fixed contributions, there is no legal or constructive obligation to pay further contributions

Full actuarial valuations of the Group s principal defined benefit schemes are carried out every three years with interim reviews in the intervening years, these valuations are updated to 31 December each year by qualified independent actuaries For the purposes of these annual updates scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method adjusted for unrecognised actuarial gains and losses The defined benefit scheme liabilities are discounted using rates equivalent to the market yields at the balance sheet date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension

The Company's share of the resulting net surplus or deficit, determined on the basis of the Company's cash contributions into the schemes for employee members (calculated in accordance with the scheme rules) is reflected in the Company's balance sheet (see Note 15) The Company's statement of comprehensive income includes the Company's share of current service cost of providing pension benefits, the expected return on the schemes' assets, net of expected administration costs, and the interest cost on the schemes' liabilities The Company's share of actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are not recognised unless the cumulative unrecognised gain or loss at the end of the previous reporting period exceeds the greater of 10 per cent of the scheme assets or liabilities ('the corridor approach') In these circumstances the excess is charged or credited to the statement of comprehensive income over the employees' expected average remaining working lives Past service costs are charged immediately to the statement of comprehensive income, unless the charges are conditional on the employees remaining in service for a specified period of time (the vesting period) In this case, the past service costs are amortised on a straight-line basis over the vesting period

The Company's balance sheet includes its share of the net surplus or deficit, being the difference between the fair value of scheme assets and the discounted value of scheme liabilities at the balance sheet date adjusted for any cumulative unrecognised actuarial gains or losses Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes

The Company recognises the effect of material changes to the terms of the Group's defined benefit pension plans which reduce future benefits as curtailments, gains and losses are recognised in the statement of comprehensive income when the curtailments occur

The costs of the Company's contributions towards the Group s defined contribution plans are charged to the statement of comprehensive income in the period in which they fall due

2 Summary of significant accounting policies (continued)

2 10 Share-based compensation

The Company's ultimate parent company operates a number of group-wide equity-settled, share-based compensation plans in respect of services received from certain of its employees The Company's share of the value of the employee services received in exchange for equity instruments granted under these plans is recognised as an expense over the vesting period of the instruments, with a corresponding increase in equity This expense is determined by reference to the fair value of the number of equity instruments that are expected to vest The fair value of equity instruments granted is based on market prices, if available, at the date of grant In the absence of market prices, the fair value of the instruments at the date of grant is estimated using an appropriate valuation technique, such as a Black-Scholes option pricing model The determination of fair values excludes the impact of any non-market vesting conditions, which are included in the assumptions used to estimate the number of options that are expected to vest At each balance sheet date, this estimate is reassessed and if necessary revised Any revision of the original estimate is recognised in the statement of comprehensive income over the remaining vesting period, together with a corresponding adjustment to equity Cancellations by employees of contributions to the Group's Save As You Earn plans are treated as non-vesting conditions and in accordance with the revised IFRS 2 the Group recognises, in the year of cancellation, the amount of the expense that would have otherwise been recognised over the remainder of the vesting period Modifications are assessed at the date of modification and any incremental charges are charged to the statement of comprehensive income over any remaining vesting period

2 11 Provisions, contingent liabilities and contingent assets

Provisions are recognised in respect of present obligations arising from past events where it is more likely than not that outflows of resources will be required to settle the obligations and they can be reliably estimated

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote

Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits Contingent assets are not recognised in financial statements since this may result in the recognition of income that may never be realised However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate A contingent asset is disclosed where an inflow of economic benefits is probable

2 12 Revenue recognition – other than insurance contracts

Income received from fixed interest investments and deposits is accrued for on a day to day basis using the effective interest rate method All such income is received and reported on a gross basis When an interest bearing asset is impaired the carrying amount is reduced to its recoverable amount, being the estimated future cash flow discounted at the original effective interest of the asset and the discount is unwound as investment income

Dividends are received and reported net of the associated tax and are accrued when the stock becomes ex-dividend within the year Dividend income is included within 'Net fair value gains on financial assets held at fair value through income'

Investment gains either realised or unrealised are reflected in the statement of comprehensive income and are calculated as the difference between either sale proceeds or market value and original cost

2 13 Dividend distribution

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

2 14 Trade payables

Trade payables primarily relate to liabilities associated with insurance contracts and their accounting policies are disclosed in Note 2 7

3 Critical accounting estimates and judgements in applying accounting policies

The Company makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year Estimates and judgments are regularly evaluated and based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances

Outstanding claims
The estimation of the ultimate liability arising from claims made under insurance contracts is the Company's most critical accounting estimate There are several sources of uncertainty that need to be considered in the estimate of the liability that the Company will ultimately pay for such claims

In particular, household and domestic all risks insurance policies are exposed to claims for subsidence The Company subscribes to the Association of British Insurers (ABI) Subsidence "Change of Insurer' Claims Agreement which places an obligation upon it to deal with subsidence claims

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 month Significant factors that affect the trends that influence subsidence performance stem mainly from the impact of the much drier weather conditions, tree root activity, the upturn in the housing market and the additional extensive press publicity generating anxiety and overreactions to minor cracking Due to this uncertainty, it is not possible to determine the future development of subsidence claims with the same degree of reliability as with other types of claim

Where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases Similar statistical techniques are used to determine a provision for claims incurred but not reported at the balance sheet date Finally, an allowance is made for the expected probability of a subsidence event occurring which could give rise to such liabilities

Due to the economic climate unemployment claims have increased significantly in the past few years compared to previous years and reporting and payment patterns have been disrupted by this and by process changes We would also expect a secondary, though smaller impact to occur within sickness claims The normal approach is to use past data to derive claims costs, but in the past few years the potential for patterns changing has been recognised and appropriate adjustments have been made as detailed in Note 4 2 2 (b)

While management believes that the liability carried at year end is adequate, the application of statistical techniques requires significant judgment An increase of 10% in the cost of all claims would result in the recognition of an additional cost of £16 041m net of reinsurance (2010 £24 689m) Similarly, an increase of 10% in the number of all claims would result in the recognition of an additional cost of £17 317m net of reinsurance (2010 £26 149m) A 5% increase in the inflation rate of claims would result in the recognition of an additional cost of £5 690m net of reinsurance (2010 £8 964m)

4 Risk management

The Company s activities expose it to a variety of risks The Company's overall risk management programme focuses on the unpredictability of non-life insurance and financial markets and seeks to minimise potential adverse effects on the Company's financial performance

4 1 Risk governance

The board of directors bears responsibility for the management of risk in the Company including approval of documented insurance and other prudential risk policies and risk appetite limits as well as monitoring adherence to such policies Risk management activities are delegated to the Operational Risk Committee and to the relevant business area directors Oversight is carried out by the Insurance Group s risk management function which acts independently The Company complies with the Group risk management framework, full details of which are published in the ultimate parent company accounts

4 Risk management (continued)

4 2 Insurance risk

The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim By the very nature of an insurance contract, this risk is random and therefore unpredictable

The principal risk that the Company faces under its insurance contracts is that the actual claims payments exceed the carrying amount of the insurance liabilities This could occur because the frequency or severity of claims is greater than estimated Insurance events are random and the actual number of claims will vary from year to year from the estimate established using statistical techniques When submitting a claim, proof will be needed The Company follows any principles set up by the ABI and FSA in respect of handling claims Claims information is retained to help with the estimation of future claim payments and risk pricing

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 across the board by a change in any subset of the portfolio The Company has developed its insurance underwriting strategy to ensure that within each of its risk categories sufficiently large populations of risks are achieved to reduce the variability of the expected outcome

4 2 1 Household and domestic all risks

(a) Frequency and severity of claims

For household and domestic all risks insurance contracts, climatic changes appear to be giving rise to more frequent and severe extreme weather events and their consequences Underwriting limits are in place to enforce appropriate risk selection criteria For example, the Company can charge a premium appropriate to the risk presented, decline to underwrite certain applications at sale, impose policy terms and conditions or higher excesses and, in the majority of cases, has the right not to renew individual policies The Company also has the right to reject the payment of a fraudulent claim Insurance contracts also entitle the Company to pursue third parties for payment of some or all costs (i e subrogation)

The Company has the right to re-price the risk on renewal and also has the ability to impose excesses These contracts are underwritten by reference to the replacement value of the properties and contents insured Claim payment limits are always included for contents insurance to cap the amount payable on occurrence of the insured event Costs of rebuilding properties or replacement of, or indemnity for, contents, are the key factors that influence the level of claims under these policies The greatest likelihood of significant losses on these contracts arises from storm, fire, flood damage, freeze and subsidence The Company has reinsurance cover for catastrophes to limit losses in any one year from large single events The maximum loss for a single event up to £767 1m is £85 2m across Lloyds Banking Group General Insurance (2010 £720m is £63m (£56m for flood)) The Company has also purchased aggregate loss cover to mitigate the effects of multiple events

The insurance risk arising from these contracts is not concentrated in any of the regions in the UK in which the Company operates, and there is a balance between buildings and contents in the overall portfolio.

(b) Sources of uncertainty in the estimation of future claim payments

Household and domestic all risks claims are analysed separately for each peril The development of accumulations of weather claims in a single catastrophic event is analysed separately The shorter settlement period for non-subsidence/liability claims allows the Company to achieve a higher degree of certainty about the estimated cost of these claims, and relatively small Incurred but not Reported ('IBNR') reserve is held at year-end However, the longer time needed to assess the emergence of a subsidence or liability claim makes the estimation process more uncertain for these claims

Further information on risk management is disclosed in Note 13

4 **Risk management (continued)**

4.2.2 Creditor

(a) Frequency and severity of claims

Significant perils and risk factors include unemployment, interest rates and the UK economic outlook generally The majority of financial loss business underwritten by the Company is payment protection, which has accident, sickness and unemployment as its main perils

The claim amount paid is fixed at the level of repayment and is capped for a maximum duration for most contracts There are waiting and exclusion periods during which no claim will be accepted In addition, in the case of sickness, any pre-existing health conditions will not be covered

The insurance risk arising from these contracts is not concentrated in any of the regions in the UK in which the Company operates A credit scoring system and procedures are in place to approve loans on which insurance will be offered

Unemployment claims during the year have continued to fall from their peak in 2009, though remain higher than prior to the recession, these changes coupled with changes to internal processes to cope with increased demand have given rise to distorted reporting and payment patterns so the Company has had to apply more judgement than usual to reflect that history is not as predictive in current circumstances In addition the Company expects that the average duration that claims will remain in payment will continue to be sensitive to prevailing economic conditions and the stressful conditions of the recession will also produce a knock-on effect on the duration of sickness claims so an allowance has been made to allow for this in the reserves

(b) Sources of uncertainty in the estimation of future claim payments

The Company estimation processes reflect all the factors that influence the amount and timing of cash flows from these contracts The shorter settlement period for these claims would normally allow the Company to achieve a higher degree of certainty about the estimated cost of claims but as stated above there remains greater uncertainty this year even as claims reduce, however, there is still a relatively small IBNR held at year-end

To reduce the uncertainty the Company has been modelling national economic data, notably unemployment inflows and their relationship to creditor claims, as well as a detailed analysis of claim transitional probabilities This latter data has been showing a changing proportion of claimants transitioning to later claim duration periods Data from the recession in the early 1990's and a range of scenarios was also used to assess the reasonableness of the reserve produced

The Company ceased writing new creditor business in 2010, consequently the book is now in run-off which in itself establishes an additional source of uncertainty in analysing the behaviours of a diminishing book against a historically stable portfolio

(c) Unexpired risk reserve

An unexpired risk reserve (URR) is required to be established when the unearned premium reserve belonging to an identifiable segment of business is insufficient to cover the estimated cost of all future claims and expenses which will attach to that unearned business

An analysis by segment was carried out and determined that an URR of £2 4m in respect of the single premium business (Loan Protection and Asset Finance) was required This was due to the expectation that future claims experience would deteriorate as a result of anti-selection caused by the PPI mis-selling judicial review

Further information on insurance risk management is disclosed in Note 13

4 3 **Financial risk**

The Company is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and insurance liabilities In particular, the key financial risk is that the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance contracts Other important components of financial risk are market risk (primarily interest rate risk), credit risk and liquidity risk

4 **Risk management (continued)**

4 3 **Financial risk (continued)**

4 3 1 Market risk

The Company is exposed to market risk (including interest rate risk) through its portfolio of investments which consist of sterling denominated debt securities and shares in a collective investment scheme, all of which are exposed to general and specific market movements An additional source of market risk is the mismatch between payout patterns of liabilities and the assets backing those liabilities However, this component is a minor source of risk for the Company as the majority of assets as well as liabilities are of a short term nature

The Company's objective in managing market risk is to maximise returns from investments whilst ensuring regulatory requirements are met and adequate financial security is maintained on an ongoing basis

i) Interest rate risk

The Company has a defined investment policy which sets out limits on the Company's exposure to its investments With the exception of the collective investment schemes, investments held are all listed and traded on recognised stock exchanges The collective investment schemes are unlisted and are authorised and regulated by the FSA and fall under the EU directive on Undertakings for Collective Investment in Transferable Securities Investment management meetings are held regularly where the Company s investments are reviewed Exposure to investments are monitored by the finance function in order to ensure compliance with internal and relevant external regulatory limits for solvency purposes and to allow additional measures to be taken if limits are breached

The market risk in the investment portfolio is measured using 'Value at Risk' (VaR) methodology VaR is defined as the maximum loss over a given time horizon, with a defined low probability that the actual loss on the portfolio will be larger A 5% VaR with a one year time horizon is used to set the Company's tolerance to market risk A loss equal to VaR is the worst case loss considered for the management of market risk

The VaR calculation allows for dependencies between the values of investments in the portfolio Its inputs include 15 years of historic movements in the values of appropriate market indices and interest rates

The VaR for the Company as at 31 December 2011 was £5 5m (2010 £5 6m) The VaR is consistent with the previous year as a result of a slight reduction in the VaR for ARBF and direct holdings being counterbalanced by a slight increase in the VaR of the Investment Cash Fund

The Company underwrites predominantly short-term insurance liabilities, i e less than 5 years, which are not directly sensitive to the level of market interest rates as they are undiscounted and contractually non-interest bearing

	2011	**2010**
A change of interest rate by +/- 1% would have the following effect on the value of the Company's investments	-/+ £0 3m	-/+ £0 7m

(ii) Price Risk

The Company's price risk exposure relates to financial assets and liabilities whose values will fluctuate as a result of changes in market prices, principally investment securities

Such investment securities are subject to price risk due to changes in market values of instruments arising either from factors specific to individual instruments or their issuers or factors affecting all instruments traded in the market

The Company s price risk policy requires it to manage such risks by setting and monitoring objectives and constraints on investments, diversification plan, limits on investment in each country, sector and market, and careful and planned use of derivative instruments The price risk on investment securities can be actively managed through the use of derivative financial instruments to mitigate the risk of adverse market movements The Company did not exercise this option at any point in the year and has none in force at the year end

(All amounts in £ thousands unless otherwise stated)

4 **Risk management (continued)**

4 3 1 Market risk (continued)

The Company holds investments appropriate to the timing, amount and level of uncertainty of its insurance contract liabilities as shown in the following table, which reconciles the balance sheet to the categories used in the Company s management of financial risk

2011

	Insurance contracts	Other financial assets & liabilities	Other assets & liabilities	Total
Intangible insurance assets	70,614	-	-	70,614
Financial assets held at fair value through income				
Collective Investment Schemes - unlisted	103,791	230,990	-	334,781
Debt securities - listed	50,998	-	-	50,998
Insurance receivables	234,106	-	-	234,106
Other receivables	-	103,893	-	103,893
Reinsurance assets	13,821	-	-	13,821
Cash and cash equivalents	222	52,846	-	53,068
	473,552	387,729	-	861,281
Insurance contracts and payables	452,584	-	-	452,584
Provisions for other liabilities and charges	-	-	2,578	2,578
Trade and other liabilities	20,968	46,694	12,111	79,773
Deferred income tax	-	-	21,436	21,436
Income tax liability	-	-	45,221	45,221
	473,552	46,694	81,346	601,592

2010

	Insurance contracts	Other financial assets & liabilities	Other assets & liabilities	Total
Intangible insurance assets	83,909	-	-	83,909
Financial assets held at fair value through income				
Collective Investment Scheme - unlisted	133,971	271,559	-	405,530
Debt securities - listed	85,004	-	-	85,004
Insurance receivables	252,747	-	-	252,747
Other receivables	-	97,729	-	97,729
Reinsurance assets	12,102	-	-	12,102
Cash and cash equivalents	9,447	39,670	-	49,117
	577,180	408,958	-	986,138
Insurance contracts and payables	565,791	-	-	565,791
Provisions for other liabilities and charges	-	-	1,187	1,187
Trade and other liabilities	11,389	76,592	11,997	99,978
Deferred income tax	-	-	22,410	22,410
Income tax liability	-	-	35,214	35,214
	577,180	76,592	70,808	724,580

(All amounts in £ thousands unless otherwise stated)

4 **Risk management (continued)**

4 3 2 Credit risk

Credit risk is the risk of loss if another party fails to perform its obligations or fails to perform them in a timely fashion

Management considers that the Company's only significant potential credit risk exposures are from reinsurance and financial assets held at fair value through income Adequate and effective procedures are in place to mitigate these exposures and all the other sources of credit risk identified by the business Credit risk exposure from insurance receivables is not considered to be significant, as the risk is diversified across a large volume of policyholders for all products and the amount of unpaid premiums at the balance sheet date is not significant

(i) Reinsurance credit risk

The Company's risk transfer policy addresses the management of reinsurance credit risk and is authorised by the Finance Director Only reinsurers with a minimum credit rating of 'A-" will be accepted The Company also requires a "special termination clause" in all contracts allowing a reinsurer to be replaced mid-term, in the event their security rating is downgraded below an acceptable level during the period of the reinsurance contract

Reinsurance claims recoveries management information is supplied to the Finance Director by the reinsurance broker The Company's actuarial function monitors the status of claims made on reinsurance policies

(ii) Investment credit risk

The Company's investment policy sets rules limiting exposure to concentrations of risk as a result of aggregation of exposure to any single counterparty Setting limits mitigates such credit risk exposure and also ensures compliance with regulatory requirements Surplus funds are invested by utilising Scottish Widows fund managers and their adherence to the exposure limit rules is monitored regularly by the Company's Asset and Liability Committee Credit default risk is the most significant financial risk, but this is mitigated by a very cautious approach to counterparty risk

The concentration of credit risk has changed compared to the prior year as Debt Securities have matured with the Company continuing to take a very prudent and cautious approach to investment The table below shows the Company's financial assets held at fair value through income split by credit rating (from Moody's)

Financial assets held at fair value through income:	**2011**	**2010**
Debt securities – listed (Note 7)		
AA	44,979	81,031
A	6,019	3,973
Total assets bearing credit risk	50,998	85,004
Collective Investment Schemes - unlisted		
AAA	281,233	352,664
Unrated	53,548	52,866
	334,781	405,530

The physical assets (i e assets other than derivatives) in which the collective investment schemes invest predominantly consist of fixed interest securities, index linked securities, money market instruments, cash and deposits

The investment in collective investment schemes decreased during the year as funds were withdrawn from the Investment Cash Fund which has an 'AAA' credit rating The unrated collective investment scheme is an Absolute Return Bond Fund

(All amounts in £ thousands unless otherwise stated)

4 **Risk management (continued)**

4.3.3 Liquidity risk

The main objective of the Company's liquidity risk policy is to ensure that all funds within the Company that serve to fulfil liabilities are available in sufficiently liquid form to settle liabilities as and when they fall due Liquidity risk is considered to be small, as the Company only holds financial assets for which there is a liquid market and that are readily saleable to meet liquidity needs together with short term cash deposits which are viewed as readily available at short notice

The table below analyses the Company's insurance and financial liabilities into relevant maturity groupings The analysis of insurance liabilities is an estimated maturity analysis of the amount recognised in the balance sheet For financial liabilities, the groupings are based on the period remaining at the balance sheet to the contractual maturity date The amounts disclosed in the table are undiscounted

	Up to 3 months	Between 3 and 12 months	Between 1 and 2 years	Over 2 years	Total
At 31 December 2011					
Insurance contracts	180,093	231,388	33,299	7,804	452,584
Trade and other payables	67,662	-	-	-	67,662
At 31 December 2010					
Insurance contracts	221,194	283,525	43,185	17,887	565,791
Trade and other payables	87,981	-	-	-	87,981

4 3 4 Operational risk

The Company is exposed to the risk of reductions in earnings and/or value, through financial or reputational loss, from inadequate or failed internal processes and systems, or from people related or external events

There are a number of categories of operational risk

- *People risk*
  The risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate staff behaviour, industrial action or health and safety issues Loss can also occur through failure to recruit, retain, train, reward and incentivise appropriately skilled staff to achieve business objectives and through failure to take appropriate action as a result of staff underperformance

- *Organisational Infrastructure*
  Includes all business processes that are "internally facing" i e operate between business areas

- *Financial Crime – External and Internal Fraud*
  The risk of reductions in earnings and/or value, through financial or reputational loss, associated with financial crime and failure to comply with related legal and regulatory obligations, these losses may include censure, fines or the cost of litigation

- *Money Laundering & Sanctions*
  Includes all activity related to money laundering, sanctions and counter terrorism

- *Legal & Regulatory*
  The risk of reductions in earnings and/or value, through financial or reputational loss, from failing to comply with the laws, regulations or codes applicable, or changes therein

- *Customer Treatment*
  The risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate or poor customer treatment

4 **Risk management (continued)**

4 3 4 Operational risk (continued)

- *Security*
  The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from theft of or damage to the Group's assets, the loss, corruption, misuse or theft of the Group's information, assets or threats or actual harm to the Group's people

- *Supplier Management*
  The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from all activity related to the agreement and management of services with other parties

- *IT Systems*
  The risk of reductions in earnings and/or value, through all activity related to the development, delivery and maintenance of effective IT solutions

- *Change*
  The risk of reductions in earnings and/or value, through financial or reputational loss, from change initiatives failing to deliver to requirements, budget or timescale or failing to implement change effectively or realise the desired benefits

- *Customer Process*
  The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from inadequate or failed internal processes and systems that are "externally facing", i e provide a service for external "customers", including counterparties, corporate clients etc

Exposures
The main sources of operational risk relate to uncertainties created by the changing business and in particular the legal and regulatory environment in which the Company operates The Company's legal and regulatory exposure is driven by the significant volume of current legislation and regulation with which it has to comply, along with new legislation and regulation which needs to be reviewed, assessed and embedded into day to day operational and business practices

Risk Framework
There are clear accountabilities and processes in place for reviewing new and changing requirements The Company has a nominated individual with 'compliance oversight' responsibility under FSA rules The role of this individual is to advise and assist management to ensure they maintain a control structure which achieves compliance with the rules and regulations, to which the Company is subject, and to monitor and report on adherence to these rules and regulations

The Company has a comprehensive and consistent operational risk management framework for the timely identification, measurement, monitoring and control of operational risk This framework is entirely aligned to that of the Lloyds Banking Group to which it belongs
Integral to this operational risk management framework is a hybrid approach to calculating capital to support unexpected losses The capital model calculations are driven by internal data which captures past losses, and forward looking scenarios which value potential future risk events External industry-wide data is collected to help with validating scenarios

Mitigation
The Company's operational risk management framework consists of five key components

1 Identification of the key operational risks facing a business area,
2 Evaluation of the effectiveness of the control framework covering each of the key risks to which the business area is exposed,
3 Evaluation of the non-financial exposures (e g reputational risk) for each of the key risks to which the business area is exposed,
4 For material risks identified, an estimate of the exposure to financial losses that could result within the coming financial year, together with an estimate of losses in a stressed environment,
5 For material risks identified an estimate of exposure to high impact, low frequency events through a scenario

Monitoring
The Company s risk exposure is reported through a monthly Consolidated Risk Report ('CRR') that is then aggregated at divisional level and reported to group risk where a group-wide report is prepared The CRR is prepared monthly and discussed at the Company's Operational Risk Committee where any particular concerns may be escalated further to the division or group risk functions

(All amounts in £ thousands unless otherwise stated)

4 **Risk management (continued)**

4.3 4 Operational risk (continued)

The Company has adopted a formal approach to operational risk event escalation This involves the identification of an event, an assessment of the materiality of the event in accordance with a risk event impact matrix and then the appropriate escalation procedures

4 4 **Fair value hierarchy of financial assets**

IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable Observable inputs reflect market data obtained from independent sources, unobservable inputs reflect the Company's assumptions These two types of inputs have created the following fair value hierarchy

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities This level includes listed equity securities and debt instruments on exchanges Although unlisted, our collective investment schemes have a price in an active market and are classified as Level 1

Level 2 – 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) There is not considered to be an active market for our debt securities which are classified as Level 2

Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs) This level includes equity investments and debt instruments with significant unobservable components

This hierarchy requires the use of observable market data when available The Company considers relevant and observable market prices in its valuations where possible

The following table presents the Company's assets measured at fair value at 31 December 2011

At 31 December 2011	Level 1	Level 2	Level 3	Total balance
Financial assets held at fair value through income				
- Collective Investment Scheme - unlisted	334,781	-	-	334,781
- Debt securities - listed	-	50,998	-	50,998
	334,781	50,998	-	385,779

At 31 December 2010	Level 1	Level 2	Level 3	Total balance
Financial assets held at fair value through income				
- Collective Investment Scheme - unlisted	405,530	-	-	405,530
- Debt securities - listed	-	85,004	-	85,004
	405,530	85,004	-	490,534

4 5 **Capital risk management**

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for the shareholder and to protect policyholders' interests, to maintain an optimal capital structure to reduce the cost of capital and to comply with capital requirements imposed by its UK regulator, the FSA

In order to maintain or adjust the capital structure to meet the objectives above including ensuring sufficient capital is held to meet capital requirements, the Company may adjust the amount of dividends paid to the shareholder, return capital to the shareholder, issue new shares, sell assets or raise debt which can be included as available capital for capital requirement purposes under FSA regulations

Consistent with other insurers in the non-life insurance industry, the FSA imposes two separate capital requirements on the Company of any significance the Minimum Capital Requirement (MCR) as defined in 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 also set out in 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

(All amounts in £ thousands unless otherwise stated)

4 Risk management (continued)

4 5 Capital risk management (continued)

For ICG purposes, total available capital is calculated as 'Total equity' as shown in the balance sheet For MCR purposes, total available capital is calculated as 'Total equity' as shown in the balance sheet net of the non-distributable reserve as described in Note 12

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

5 Intangible insurance assets

Intangible assets relate to the deferred acquisition costs of acquiring new and renewing existing insurance contracts

Deferred acquisition costs	**2011**	**2010**
At 1 January	83,909	119,588
Additions	183,795	189,488
Amortisation through income (Note 22)	(197,090)	(225,167)
At 31 December	70,614	83,909
Available within one year	68,985	75,043
Available after one year	1,629	8,866

6 Financial instruments by category

The accounting policies for financial instruments have been applied to the line items below

31 December 2011	**Assets at fair value through income**	**Loans and receivables**	**Total**
Assets			
Financial assets at fair value through income			
- Collective Investment Schemes - unlisted	334,781	-	334,781
- Debt securities - listed	50,998	-	50,998
Amounts due from related parties	-	103,872	103,872
Cash and cash equivalents	-	53,068	53,068
Total	385,779	156,940	542,719

	Other liabilities at amortised cost	**Total**
Liabilities		
Trade and other payables	46,694	46,694
Total	46,694	46,694

(All amounts in £ thousands unless otherwise stated)

6 **Financial instruments by category (continued)**

31 December 2010	**Assets at fair value through income**	**Loans and receivables**	**Total**
Assets			
Financial assets at fair value through income			
- Collective Investment Scheme - unlisted	405,530	-	405,530
- Debt securities - listed	85,004	-	85,004
Amounts due from related parties	-	97,583	97,583
Cash and cash equivalents	-	49,117	49,117
Total	490,534	146,700	637,234

	Other liabilities at amortised cost	**Total**
Liabilities		
Trade and other payables	76,592	76,592
Total	76,592	76,592

7 **Financial assets**

The Company's financial assets are summarised below by measurement category in the table below

	2011	**2010**
Fair value through income		
Collective Investment Schemes – unlisted	334,781	405,530
Debt securities – listed		
- floating rate	50,998	85,004
Total financial assets held at fair value through income	385,779	490,534
Loans and receivables including insurance receivables (Note 8)	337,999	350,476
Cash and cash equivalents	53,068	49,117
Total financial assets	776,846	890,127
Available within one year	776,846	800,127
Available after one year	-	90,000

The movements on financial assets held at fair value through income are detailed below

	2011	**2010**
At 1 January	490,534	81,183
Additions	40,298	585,646
Disposals (sale and redemptions)	(147,902)	(179,906)
Fair value net gains (excluding net realised gains and losses)	2,864	3,517
(Decrease)/increase in accrued income	(15)	94
At 31 December	385,779	490,534

(All amounts in £ thousands unless otherwise stated)

8 Loans and receivables including insurance receivables

	2011	2010
Receivables arising from insurance and reinsurance contracts		
- due from contract holders	234,106	252,747
Loans and receivables		
- amounts due from related parties (Note 29)	103,872	97,583
Prepayments	21	146
Total loans and receivables including insurance receivables	337,999	350,476
Available within one year	337,999	260,476
Available after one year	-	90,000

As at 31 December 2011 all overdue loans and receivables arising from insurance contracts were provided for in full.

9 Reinsurance assets

	2011	2010
Reinsurers' unearned premium	12,455	10,447
Reinsurers share of claims reserves	1,366	1,655
Reinsurance assets	13,821	12,102
Available less than one year	12,987	10,990
Available greater than one year	834	1,112

All of the above amounts relate to household and domestic all risks contracts of insurance

(All amounts in £ thousands unless otherwise stated)

10 Cash and cash equivalents

	2011	2010
Cash at bank and in hand	2,052	3,208
Short-term bank deposits	50,742	36,437
Global Liquidity Fund	222	9,447
Total cash and cash equivalents for cash flow purposes	53,016	49,092
Accrued interest	52	25
Total cash and cash equivalents	53,068	49,117

The Global Liquidity Fund is a managed investment fund investing in short term highly liquid investments, which together with the Company s financial assets held at fair value through income, is managed by a related party (Note 29)

The effective interest rate on cash and cash equivalents was 0 80% (2010 0 64%)

11 Share capital

	2011	2010
Ordinary shares		
At 1 January and 31 December		
Issued and fully paid – 61 7m shares of £1 each	61,700	61,700
	61,700	61,700

The total authorised number of ordinary shares is 65 661 million (2010 65 661million) with a nominal value of £1 each

The ordinary shares of £1 each carry the right to receive dividends proposed by the directors and the right to vote at general meetings Upon winding up, the ordinary shares carry the right to a return of capital together with any surplus in retained earnings or less any accumulated deficits

12 Retained earnings

	2011	2010
Undistributable reserve for unrealised gains on financial assets held at fair value through income (net of corporation tax)	6,263	4,005
Other reserves	191,726	195,853
Total retained earnings at 31 December	197,989	199,858

Other reserves represent the amount available for dividend distribution to the equity shareholder of the Company except for £64 312m (2010 £60 595m) which is not distributable and must be kept in compliance with the solvency capital regulations that require the Company to retain this as an equalisation reserve The amount in the equalisation reserve becomes available for distribution when the Company has suffered insurance losses in excess of levels set out in the relevant solvency capital regulations

(All amounts in £ thousands unless otherwise stated)

13 Insurance liabilities and reinsurance assets

	2011	2010
Gross		
Short-term insurance contracts		
- claims reported and loss adjustment expenses	143,240	213,624
- claims incurred but not reported	29,930	47,869
- unearned premiums	277,014	304,298
- unexpired risk reserve	2,400	-
Total insurance liabilities - gross	452,584	565,791
Recoverable from reinsurers		
Short-term insurance contracts		
- claims reported	1,366	1,655
- claims incurred but not reported	-	-
- unearned premiums	12,455	10,447
- unexpired risk reserve	-	-
Total reinsurers' share of insurance liabilities	13,821	12,102
Net		
Short-term insurance contracts		
- claims reported and loss adjustment expenses	141,874	211,969
- claims incurred but not reported	29,930	47,869
- unearned premiums	264,559	293,851
- unexpired risk reserve	2,400	-
Total insurance liabilities – net	438,763	553,689
Payable within one year	398,494	493,728
Payable after more than one year	40,269	59,961

The gross claims reported, claims expenses liabilities and liability for claims incurred but not reported are net of expected recoveries from salvage and subrogation The amounts for salvage and subrogation at the end of 2011 and 2010 are not material

13 1 Short-term insurance contracts – assumptions, changes in assumptions and sensitivity

The methodology and assumptions used in relation to determining the bases of the earned premium and claims provisioning levels are derived for each individual underwritten product and contained within the appropriate software programmes of the in-house policy underwriting system Assumptions are intended to be neutral estimates of the most likely or expected outcome (best estimates')

The levels, adequacies and assumptions used to determine these claims reserves are set out in the Quarterly Reserving and Claims Reports (QRR)

The report from the Head of Actuarial and recommendations are formally reviewed by the Claims and Reserving Committee on a quarterly basis

An analysis of methodology and assumptions in calculating technical reserves is shown below for each significant product class

13 **Insurance liabilities and reinsurance assets (continued)**

13 1 **Short-term insurance contracts – assumptions, changes in assumptions and sensitivity (continued)**

13.1.1 Household and domestic all risks

Significant perils and losses factors include accidental damage, escape of water, subsidence, public liability and adverse weather The reserving methodology and associated assumptions are set out below

Outstanding Claims Reserve (OCR)
The aim of the OCR review for household and domestic all risks is to generate a best estimate weighted average OCR using various actuarial techniques including a chain ladder statistical projection method applied to past claims paid, case estimates and claims volume data for each peril separately Consideration is also given to the impact any change in claims processing will have on the estimate If considerable uncertainty exists, then an uncertainty provision will be identified and documented within the reserving reports

Claims Incurred But Not Reported Reserve (IBNR)
The aim of the IBNR review is to assess the appropriateness of the IBNR factors used to set the IBNR reserve To do this, a chain ladder statistical projection method is applied to past claims volume reported triangles

Major events such as storms or floods are treated separately using development patterns appropriate to that type of event In addition, additional provisions are established for liability and fire claims to reflect the additional volatility over and above that seen in the available data

Unearned Premium Reserve (UPR)
The UPR is calculated using a daily allocation method These are annual policies but the majority of policyholders pay premiums by monthly instalments and accordingly a substantial part of the asset backing the UPR is future monthly premiums

13 1 2 Creditor

Significant perils and loss factors include unemployment, morbidity, interest rates and the UK economic outlook generally The vast majority of financial loss business underwritten by the Company consists of loan protection covering accident, sickness and unemployment The reserving methodology and associated assumptions for loan protection are set out below

Outstanding Claims Reserve (OCR)
The OCR is calculated as the product of the number of active claims, the average duration remaining and the monthly repayment amount The average claim duration assumption is based on past experience of loan protection data adjusted for the current economic conditions The adjustment was made on a judgemental basis, taking into account the most recent data and economic predictions as well as the data on similar products in the early 90's

Claims Incurred But Not Reported Reserve (IBNR)
The IBNR is calculated in the same way as the OCR, though uses total duration An alternative reserving technique, using the chain ladder statistical projection method applied to past claims data is used to provide an independent check on the adequacy of the OCR plus IBNR

Unearned Premium Reserve (UPR)
Earned premiums are calculated on a basis that reflects the length of time for which contracts have been in force and the projected incidence of risk over the term of each contract

Unexpired Risk Reserve (URR)

An unexpired risk reserve (URR) is required to be established when the unearned premium reserve belonging to an identifiable segment of business is insufficient to cover the estimated cost of all future claims and expenses which will attach to that unearned business

An analysis by segment was carried out and determined that an URR of £2 4m in respect of the single premium business (Loan Protection and Asset Finance) was required This was due to the expectation that future claims experience would deteriorate as a result of anti-selection caused by the PPI mis-selling judicial review

(All amounts in £ thousands unless otherwise stated)

13 **Insurance liabilities and reinsurance assets (continued)**

13 1 **Short-term insurance contracts – assumptions, changes in assumptions and sensitivity (continued)**

13 1 3 Claims development tables

The development of insurance liabilities provides a measure of the Company's ability to estimate the ultimate value of claims The top half of each of the following tables below illustrates how the Company's estimate of total claims outstanding for each accident year has changed at successive year-ends The bottom half of the table reconciles the cumulative claims to the amount appearing in the balance sheet The accident year basis is considered the most appropriate for the business written by the Company

Household and domestic all risks - gross **Accident year**	**2007**	**2008**	**2009**	**2010**	**2011**	**Total**
Estimate of ultimate claims costs						
- at end of accident year	279,562	151,107	161,951	174,685	139,803	907,108
- one year later	275,760	146,736	153,194	168,892	-	-
- two years later	266,666	145,667	138,663	-	-	-
- three years later	260,654	138,908	-	-	-	-
- four years later	254,222	-	-	-	-	-
Current estimate of cumulative claims	254,222	138,908	138,663	168,892	139,803	840,488
Cumulative payments to date	(252,430)	(134,900)	(131,859)	(150,145)	(77,696)	(747,030)
Liability recognised in the balance sheet	1,792	4,008	6,804	18,747	62,107	93,458
Liability in respect of prior years						6,029
Total gross liability included in the balance sheet						99,487

Household and domestic all risks - net **Accident year**	**2007**	**2008**	**2009**	**2010**	**2011**	**Total**
Estimate of ultimate claims costs						
- at end of accident year	270,968	151,107	161,951	174,685	139,803	898,514
- one year later	265,419	146,736	153,194	168,892	-	-
- two years later	256,353	145,667	138,663	-	-	-
- three years later	251,161	138,908	-	-	-	-
- four years later	244,729	-	-	-	-	-
Current estimate of cumulative claims	244,729	138,908	138,663	168,892	139,803	830,995
Cumulative payments to date	(243,170)	(134,900)	(131,859)	(150,145)	(77,696)	(737,770)
Liability recognised in the balance sheet	1,559	4,008	6,804	18,747	62,107	93,225
Liability in respect of prior years						4,896
Total net liability included in the balance sheet						98,121

As at the year ended 31 December 2011 the Company limited its exposure to loss within insurance operations through participation in reinsurance arrangements The household portfolio is protected through a catastrophe excess of loss arrangement which operates across both Lloyds Banking Group General Insurance legal entities The nature of the programme, which was renewed on 1 July 2011, is very similar to that put in place in previous years Amounts recoverable from reinsurers were estimated in a manner consistent with the assumptions used for ascertaining the underlying policy benefits The purpose of a household excess of the loss catastrophe reinsurance programme is to protect against the adverse effects of large weather related events

The gross liability of £99 487m and net liability of £98 121m shown in the above tables exclude £9 289m of unallocated claims handling expenses

(All amounts in £ thousands unless otherwise stated)

13 **Insurance liabilities and reinsurance assets (continued)**

13 1 **Short-term insurance contracts – assumptions, changes in assumptions and sensitivity (continued)**

13.1.3 Claims development tables (continued)

Creditor – gross and net **Accident year**	**2007**	**2008**	**2009**	**2010**	**2011**	**Total**
Estimate of ultimate claims costs						
- at end of accident year	36,176	52,607	99,120	70,832	44,112	302,847
- one year later	33,558	51,357	82,879	45,386	-	-
- two years later	30,743	48,730	75,871	-	-	-
- three years later	29,911	47,153	-	-	-	-
- four years later	29,702	-	-	-	-	-
Current estimate of cumulative claims	29,702	47,153	75,871	45,386	44,112	242,224
Cumulative payments to date	(29,567)	(45,869)	(64,212)	(34,087)	(9,138)	(182,873)
Liability recognised in the balance sheet	135	1,284	11,659	11,299	34,974	59,351
Liability in respect of prior years						13
Total liability included in the balance sheet						59,364

The Company has not had any reinsurance cover in place for the current and preceding 5 years in respect of financial loss risks

The liability of £59 364m shown in the above table excludes £3 470m of unallocated claims handling expenses

13 2 **Movements in insurance liabilities and reinsurance assets**

(a) Claims and loss adjustment expenses

	2011			**2010**		
	Gross	**Reinsurance**	**Net**	**Gross**	**Reinsurance**	**Net**
Notified claims	213,624	(1,655)	211,969	164,861	(2,674)	162,187
Incurred but not reported	47,869	-	47,869	58,543	-	58,543
Total at beginning of year	261,493	(1,655)	259,838	223,404	(2,674)	220,730
Cash paid for claims settled in the year	(229,069)	290	(228,779)	(218,734)	191	(218,543)
Increase in liabilities (see Note 21)						
- arising from current year claims	209,844	-	209,844	277,191	-	277,191
- arising from prior year claims	(69,098)	(1)	(69,099)	(20,368)	828	(19,540)
Total at end of year	173,170	(1,366)	171,804	261,493	(1,655)	259,838
Notified claims	143,240	(1,366)	141,874	213,624	(1,655)	211,969
Incurred but not reported	29,930	-	29,930	47,869	-	47,869
Total at end of year	173,170	(1,366)	171,804	261,493	(1,655)	259,838

There has been no significant change year on year in the assumptions and methodologies used for setting the best estimate reserves, other than the specific adjustments made to creditor reserves to allow for the effect of economic conditions on development patterns as described in Note 13 1 2

(All amounts in £ thousands unless otherwise stated)

13 **Insurance liabilities and reinsurance assets (continued)**

13 2 **Movements in insurance liabilities and reinsurance assets (continued)**

(b) Unearned premiums and unexpired short-term insurance risks

	2011			2010		
	Gross	**Reinsurance**	**Net**	**Gross**	**Reinsurance**	**Net**
Unearned premiums						
At 1 January	304,298	(10,447)	293,851	386,438	(11,391)	375,047
Increase in the year (see Note 18)	559,502	(27,602)	531,900	594,137	(20,698)	573,439
Release in the year (see Note 18)	(586,786)	25,594	(561,192)	(676,277)	21,642	(654,635)
At 31 December	277,014	(12,455)	264,559	304,298	(10,447)	293,851
Unexpired risk reserve						
At 1 January	-	-	-	-	-	-
Increase in the year (see Note 21)	2,400	-	2,400	-	-	-
Release in the year (see Note 21)	-	-	-	-	-	-
At 31 December	2,400	-	2,400	-	-	-

These provisions represent the liability for short-term insurance contracts for which the Company's obligations are not expired at year-end The unexpired risk provision relates to creditor policies for which the Company expects to pay claims in excess of the related unearned premium provision

14 **Provision for other liabilities and charges**

	Premium Rebates	**FSCS Levy**	**Total**
At 1 January 2011	603	584	1,187
Used during the year	(2,024)	(826)	(2,850)
Statement of comprehensive income charge			
- additional provisions	1,752	826	2,578
- under/(over)-provision from prior years	1,421	242	1,663
At 31 December 2011	1,752	826	2,578

In accordance with the ABI Statement of Recommended Practice a provision has been made in respect of premiums that may be refunded in the future but on which the premiums have already been fully earned This estimate has been based upon prior experience and also includes an amount in respect of potential rebates required for customers identified as having dual insurance cover

Financial Services Compensation Scheme ('FSCS') Levy

This levy relates to the amount payable to the Financial Services Compensation Scheme (FSCS) in the event of the failure of a company regulated under the FSA The FSA has until 31 March 2012 to finalise its levy in respect of its financial year 2011/12, and 31 March 2013 in respect of 2012/13 It is not anticipated that any further levy will be raised for 2011/12 The maximum levy which can be raised is estimated to be £12 4m for the 2011 basis year (2012/13) The FSCS has issued its Plan and Budget for 2012/13 and a provision of £0 8m in respect of this levy is held in these financial statements

All provisions are deemed to be payable within one year

(All amounts in £ thousands unless otherwise stated)

15 Trade and other payables

	2011	2010
Amounts owed to related parties (Note 29)	47,856	80,286
Insurance payables	20,968	11,389
Other payables and accrued expenses	1,804	971
Social security and other taxes payable	9,145	7,332
At 31 December	79,773	99,978

	2011	2010
Non-current liabilities Included in the amounts due to related parties is an amount payable in respect of the Company's share of retirement benefit deficit (Note 17)	2,966	4,665

All other trade and other payables are current liabilities

16 Deferred income tax

Deferred income tax is calculated in full on temporary differences under the liability method using a tax rate of 25% (2010 27%) Legislation to reduce the main rate of corporation tax from 26% to 25% from 1 April 2012 has been included in the Finance Act 2011 and substantively enacted on 5 July 2011 Accordingly Deferred tax has been recognised at 25%

In his Budget speech on 21 March 2012 the Chancellor announced a further reduction in the rate of corporation tax to 24% with effect from 1 April 2012 This further reduction is expected to be enacted under the Provisional Collection of Taxes Act 1968 on 26 March 2012

The proposed further reductions in the rate of corporation tax by 1% per annum to 22% by 1 April 2014 are expected to continue to be enacted separately each year The effect of these further changes upon the Company's deferred tax balances is not quantifiable at this time

The gross movement on the deferred income tax account is as follows.

	2011	2010
At 1 January	22,410	22,340
Statement of comprehensive income (credit)/charge (Note 24)	(974)	70
At 31 December	21,436	22,410

The movement in the deferred tax assets and liabilities during the year without taking into consideration the offsetting of balances within the same tax jurisdiction is as follows

(a) Deferred tax assets

	Accelerated capital allowances	Total
At 1 January 2010	(2)	(2)
Statement of comprehensive income credit during 2010	-	-
At 31 December 2010	(2)	(2)
Statement of comprehensive income credit during 2011	-	-
At 31 December 2011	(2)	(2)

(All amounts in £ thousands unless otherwise stated)

16 **Deferred income tax (continued)**

(b) Deferred tax liabilities

	Equalisation reserve and other temporary differences	**Total**
At 1 January 2010	22,342	22,342
Statement of comprehensive income charge during 2010	70	70
At 31 December 2010	22,412	22,412
Statement of comprehensive income credit during 2011	(974)	(974)
At 31 December 2011	21,438	21,438

All of the deferred tax assets were available for offset against deferred tax liabilities and hence the net deferred tax provision at 31 December 2011 was £21 436m (2010 £22 410m)

Deferred tax has been provided at 25% (2010 27%)

The deferred tax liability due, expected to arise after more than one year is £21 436m (2010 £22 410m)

The solvency regulations in the UK require the Group to establish an equalisation reserve to be utilised against abnormal future losses arising in certain classes of business The regulations prescribe that the reserve is increased every year by an amount that is calculated as a percentage of net premiums written for those classes during the financial year These amounts are deductible expenses for tax purposes The equalisation reserve is taxed when released

17 **Retirement benefit obligations**

The Company does not directly employ staff However, the Company's share of costs relating to the Group's defined benefit schemes is reflected through the statement of comprehensive income in a management charge from a fellow subsidiary (Note 22) and on the balance sheet as a payable to related parties (Notes 15 and 29)

Full details can be found in the 2011 annual report and accounts of the Company's ultimate parent company Copies of the ultimate parent company's 2011 annual report and accounts may be obtained from the Company Secretary's Department, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN

18 **Net premium revenue**

	2011	**2010**
Short-term insurance contracts		
- premiums receivable	559,502	594,137
- change in unearned premium reserve	27,284	82,140
Premium revenue arising from insurance contracts issued	586,786	676,277
Short-term reinsurance contracts		
- premiums payable	(27,602)	(20,698)
- change in unearned premium reserve	2,008	(944)
Premium revenue ceded to reinsurers on insurance contracts issued	(25,594)	(21,642)
Net premium revenue	561,192	654,635

(All amounts in £ thousands unless otherwise stated)

19 Investment income

	2011	2010
Cash and cash equivalents interest income	4,568	5,139

Included in interest income is £4 452m (2010 £4 254m) income from accounts placed with a fellow Group subsidiary

20 Net fair value gains/(losses) on assets held at fair value through income

	2011	2010
Net fair value gains/(losses) on assets held at fair value through income		
- fair value gains	6,557	5,878
- fair value losses	(490)	(1,010)
	6,067	4,868

Fair value gains include gains arising from interest of £0 808m (2010 £1 099m) and dividends of £0 988m (2010 £1 968m) on financial assets held at fair value through income Net fair value gains/(losses) on assets held at fair value through income include net realised gains of £2 312m (2010 £0 265m) and net unrealised gains of £1 876m (2010 £1 549m)

Net fair value gains/(losses) on assets held at fair value through income includes net gains of £0 029m (2010 £0 083m) and interest income of £0 033m (2010 £0 029m) in respect of an investment held in a Floating Rate Note issued by a fellow group subsidiary that was acquired by the ultimate parent company on 19 January 2009 (Note 29) which matured on 7 December 2011

21 Insurance claims and loss adjustment expenses

	2011			2010		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
Current year claims and loss adjustment expenses	209,844	-	209,844	277,191	-	277,191
Movement in costs of prior year claims and loss adjustment expenses	(69,098)	(1)	(69,099)	(20,368)	828	(19,540)
Movement in the expected cost of claims for unexpired risks	2,400	-	2,400	-	-	-
Total claims and loss adjustment expenses	143,146	(1)	143,145	256,823	828	257,651

(All amounts in £ thousands unless otherwise stated)

22 Expenses by nature

	2011	2010
Employee benefit expense (Note 23)	37,843	43,963
Software and other IT costs	21,666	17,001
Auditor's remuneration		
- Statutory Audit	100	104
- Non-audit services pursuant to regulation	28	27
Other recharged costs	30,564	22,160
Total costs re-charged (Note 29)	90,201	83,255
Allocated as loss adjustment expenses	(34,219)	(33,960)
Allocated as acquisition expenses	(5,198)	(7,416)
Investment management fees	491	408
Other costs	5,939	8,591
Marketing and administration expenses	57,214	50,878
Amortisation of acquisition expenses (Note 5)	197,090	225,167
	254,304	276,045

Marketing costs relating to the acquiring of new and renewing of existing insurance contracts are included as part of acquisition expenses

Investment management fees are shown as part of marketing and administration expense

23 Employee benefit expense

	2011	2010
Wages and salaries	25,452	31,266
Social security costs	3,151	2,912
Pension costs (Note 17)	2,241	2,683
Share based payments (Note 28)	678	1,112
Other staff costs	6,321	5,990
	37,843	43,963

Although the Company does not directly employ any staff, staff costs are incurred by the Company and these have been identified as part of the overall management recharge above (Note 22)

Included in the pension costs charge above is an amount of £0 202m (2010 £0 214m) representing the Company's share of retirement benefit obligations under IAS 19, of the Group's defined benefit pension schemes (Note 17), the balance of the pension costs relate to defined contribution schemes

The average number of staff by activity for whom a recharge has been made during the year was as follows

	2011	2010
Administration and finance	772	670
Underwriting	27	32
Claims	325	451
	1,124	1,153

(All amounts in £ thousands unless otherwise stated)

24 Income tax expense

	2011	2010
Current income tax		
- current year	45,221	35,214
- prior years	-	702
	45,221	35,916
Deferred tax (credit)/charge (Note 16)	(974)	70
	44,247	35,986

The charge for income taxation on the profit for the year is based on an effective United Kingdom corporation taxation rate of 26 5% (2010 28%) as the standard corporation taxation rate changed from 28% to 26% effective 1 April 2011

A reconciliation of the current taxation charge for the year to the charge that would result from applying the standard United Kingdom corporation taxation rate to profit before taxation is given below

	2011	2010
Profit before tax	174,378	130,946
Tax charge at effective UK corporation tax rate of 26 5% (2010 28%)	46,210	36,665
Non-taxable income	(261)	(551)
Effect of reduction in deferred tax rate to 25% (2010 27%)	(1,702)	(830)
Adjustments in respect of prior years	-	702
Tax charge for the year	44,247	35,986

The effective tax rate for the year is 25% (2010 27%)

25 Dividend per share

Interim dividends of £132m (£2 14 per share) were paid during the year in respect of 2011 Interim dividends of £119m (£1 93 per share) were paid during the year in respect of 2010

The directors do not recommend any further dividend in respect of 2011

26 Cash generated by operations

	2011	2010
Cash flow from operating activities		
Profit before income tax	174,378	130,946
Adjustments for		
Investment income and net fair value gains on assets held at fair value through income	(10,635)	(10,007)
	163,743	120,939
Decrease in intangible insurance assets	13,295	35,679
Decrease in loans and receivables including insurance receivables	12,477	17,516
Decrease in insurance contract liabilities (net)	(114,926)	(42,088)
Increase/(decrease) in provisions for other liabilities and charges	1,391	(1,464)
Decrease in trade and other payables	(20,205)	(70,250)
Cash generated by operations	55,775	60,332

27 **Contingencies and commitments**

Except as stated in Note 14, in the opinion of the directors, there were no material contingent liabilities or commitments requiring disclosure (2010 £nil)

28 **Share based payments**

During the year ended 31 December 2011, the Company's ultimate parent company operated the following share based payment schemes, all of which are equity settled

Executive share option scheme

The executive share option schemes were long-term incentive schemes available to certain senior executives of Lloyds Banking Group plc, with grants usually made annually Options were granted within limits set by the rules of the schemes relating to the number of shares under option and the price payable on the exercise of options The last grant of executive options was made in August 2005 These options were granted without a performance multiplier and the maximum limit for the grant of options in normal circumstances was three times annual salary Between April 2001 and August 2004, the aggregate value of the award based upon the market price at the date of grant could not exceed four times the executive's annual remuneration and, normally, the limit for the grant of options to an executive in any one year would be equal to 1 5 times annual salary with a maximum performance multiplier of 3 5 Prior to 18 April 2001, the normal limit was equal to one year's remuneration and no performance multiplier was applied

Performance conditions for executive options

For options granted up to March 2001

The performance condition was that growth in earnings per share must be equal to the aggregate percentage change in the Retail Prices Index plus three percentage points for each complete year of the relevant period together with a further condition that Lloyds Banking's ranking based on total shareholder return (calculated by reference to both dividends and growth in share price) over the relevant period should be in the top fifty companies of the FTSE 100

The relevant period for the performance conditions began at the end of the financial year preceding the date of grant and continued until the end of the third subsequent year following commencement or, if not met, the end of such later year in which the conditions were met Once the conditions were satisfied the options remained exercisable without further conditions If they were not satisfied by the tenth anniversary of the grant the options would lapse

For options granted from August 2001 to August 2004

The performance condition was linked to the performance of Lloyds Banking Group plc s total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 17 companies including Lloyds Banking Group plc

The performance condition was measured over a three year period which commenced at the end of the financial year preceding the grant of the option and continued until the end of the third subsequent year If the performance condition was not then met, it was measured at the end of the fourth financial year If the condition was not then met, the options would lapse

To meet the performance conditions, the Lloyds Banking Group plc's ranking against the comparator group was required to be at least ninth The full grant of options only became exercisable if the Lloyds Banking Group plc was ranked first A performance multiplier (of between nil and 100 per cent) was applied below this level to calculate the number of shares in respect of which options granted to Executive Directors would become exercisable, and were calculated on a sliding scale If Lloyds Banking Group plc was ranked below median the options would not be exercisable

Options granted to senior executives other than Executive Directors were not so highly leveraged and, as a result, different performance multipliers were applied to their options For the majority of executives, options were granted with the performance condition but with no performance multiplier

28 **Share based payments (continued)**

Executive share option scheme (continued)

For options granted in 2005

The same conditions apply as for grants made up to August 2004, except that

- the performance condition was linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 15 companies including Lloyds Banking Group plc,
- if the performance condition was not met at the end of the third subsequent year, the options would lapse, and
- the full grant of options became exercisable only if Lloyds Banking Group was ranked in the top four places of the comparator group A sliding scale applied between fourth and eighth positions If Lloyds Banking Group was ranked below the median (ninth or below) the options would lapse

Save-As-You-Earn schemes

Eligible employees may enter into contracts through the Save-As-You-Earn schemes to save up to £250 per month and, at the expiry of a fixed term of three, five or seven years, have the option to use these savings within six months of the expiry of the fixed term to acquire shares in the Lloyds Banking Group plc at a discounted price of no less than 80 per cent of the market price at the start of the invitation

Other share option plans

Lloyds Banking Group executive share plan 2003

The plan was adopted in December 2003 and under the plan share options may be granted to senior employees Options under this plan have been granted specifically to facilitate recruitment and as such were not subject to any performance conditions The plan's usage has now been extended to not only compensate new recruits for any lost share awards but also to make grants to key individuals for retention purposes with, in some instances, the grant being made subject to individual performance conditions

Lloyds Banking Group Share Buy Out Awards

As part of arrangements to facilitate the recruitment of certain Executives, options have been granted by individual deed and, where appropriate, in accordance with the Listing Rules of the UK Listing Authority

The awards were granted in recognition that the Executives' outstanding awards over shares in their previous employing company lapsed on accepting employment with the Lloyds Banking Group

Other share plans

Lloyds Banking Group long-term incentive plan

The Long Term Incentive Plan (LTIP) introduced in 2006 is aimed at delivering shareholder value by linking the receipt of shares to an improvement in the performance of Lloyds Banking Group plc over a three year period Awards are made within limits set by the rules of the plan, with the limits determining the maximum number of shares that can be awarded equating to three times annual salary In exceptional circumstances this may increase to four times annual salary

28 **Share based payments (continued)**

Other share plans (continued)

Lloyds Banking Group long-term incentive plan (continued)

The performance conditions for awards made in March, April and August 2008 are as follows

i For 50 per cent of the award (the EPS Award) – the percentage increase in earnings per share of Lloyds Banking Group plc (on a compound annualised basis) over the relevant period needed to be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the Retail Prices Index over the same period If it was less than 3 per cent per annum the EPS Award would lapse If the increase was more than 3 per cent but less than 6 per cent per annum then the proportion of shares released would be on a straight line basis between 17 5 per cent and 100 per cent The relevant period commenced on 1 January 2008 and ended on 31 December 2010

ii For the other 50 per cent of the award (the TSR Award) – it was necessary for Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) to exceed the median of a comparator group (13 companies) over the relevant period by an average of 7 5 per cent per annum for the TSR Award to vest in full 17 5 per cent of the TSR Award would vest where the Lloyds Banking Group plc's total shareholder return was equal to median and vesting would occur on a straight line basis in between these points Where Lloyds Banking Group plc's total shareholder return was below the median of the comparator group, the TSR Award would lapse The relevant period commenced on 6 March 2008 and ended on 5 March 2011

In 2008, awards were made of 375 per cent of base salary to the Lloyds Banking Group plc Chief Executive and two of the Lloyds Banking Group plc Executive Directors for retention purposes, and in light of data reviewed by the Remuneration Committee which showed total remuneration to be behind median both for the FTSE 20, and the other major UK banks

As a consequence of the acquisition of HBOS and the general market turmoil, in March 2009 the Lloyds Banking Group plc Remuneration Committee decided that the performance test for the 2008 awards should be based on the performance of Lloyds Banking Group plc up to 17 September 2008, the date prior to the announcement of the HBOS acquisition The performance test was on a fair value basis, on the estimated probability, as at that date, of achieving the performance conditions

The performance conditions for awards made in April, May and September 2009 are as follows

i Earnings per share (EPS) relevant to 50 per cent of the award Performance will be measured based on EPS growth over a three year period from the baseline EPS of 2008

ii Economic Profit (EP) relevant to 50 per cent of the award Performance will be measured based on the extent to which cumulative EP targets are achieved over the three year period

An additional discretionary award was made in April, May and September 2009 The performance conditions for those awards are as follows

i Synergy Savings The release of 50 per cent of the shares will be dependent on the achievement of target run rate synergy savings in 2009 and 2010 as well as the achievement of sustainable synergy savings of at least £1 5 billion by the end of 2011 The award will be broken down into three equally weighted annual tranches Performance will be assessed at the end of each year against annual performance targets based on a trajectory to meet the 2011 target The extent to which targets have been achieved will determine the proportion of shares to be banked each year Any release of shares will be subject to the Lloyds Banking Group plc Remuneration Committee judging the overall success of the delivery of the integration programme

ii Integration Balanced Scorecard The release of the remaining 50 per cent of the shares will be dependent on the outcome of a Balanced Scorecard of non-financial measures of the success of the integration in each of 2009, 2010 and 2011 The Balanced Scorecard element will be broken down into three equally weighted tranches The tranches will be crystallised and banked for each year of the performance cycle subject to separate annual performance targets across the four measurement categories of Building the Business, Customer, Risk and People and Organisation Development

28 Share based payments (continued)

Other share plans (continued)

Lloyds Banking Group long-term incentive plan (continued)

The performance conditions for awards made in March and August 2010 are as follows

i EPS relevant to 50 per cent of the award Performance will be measured based on EPS growth over a three-year period from the baseline EPS of 2009

ii EP relevant to 50 per cent of the award Performance will be measured based on the compound annual growth rate of adjusted EP over the three financial years starting on 1 January 2010 relative to an adjusted 2009 Economic Profit base

The performance conditions for awards made in March and September 2011 are as follows

i EPS relevant to 50 per cent of the award The performance target is based on 2013 adjusted EPS outcome

ii EP relevant to 50 per cent of the award The performance target is based on 2013 adjusted EP outcome

Share incentive plan

Free shares

An award of shares may be made annually to employees based on a percentage of each employee's salary in the preceding year up to a maximum of £3,000 The percentage is normally announced concurrently with Lloyds Banking Group plc's annual results and the price of the shares awarded is announced at the time of award The shares awarded are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares The award is subject to a non-market based condition if an employee leaves the Lloyds Banking Group plc within this three year period for other than a 'good' reason, all of the shares awarded will be forfeited

The last award of free shares was made in 2008

Matching shares

Lloyds Banking Group plc undertakes to match shares purchased by employees up to the value of £30 per month, these matching shares are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares The award is subject to a non-market based condition if an employee leaves within this three year period for other than a 'good' reason, 100 per cent of the matching shares are forfeited Similarly if the employees sell their purchased shares within three years, their matching shares are forfeited

The number of shares awarded relating to matching shares in 2011 was 30,999,387 (2010 17,411,651), with an average fair value of £0 42 (2010 £0 63), based on market prices at the date of award

Other information

The charge made to the income statement represents the Company's share of the cost of the above schemes This charge has been allocated to the Company based on the number of the Company's employees who participate in the above schemes It is not practicable for the Company to provide information regarding the ranges of exercise prices, weighted average exercise prices, weighted average remaining contractual life information and the number of options outstanding that is specific to the Company's employees without incurring significant additional cost

Full details of the ranges of exercise prices, weighted average exercise prices, weighted average remaining contractual life information and number of options outstanding for the above schemes overall can be found in the 2011 annual report and accounts of the Company's ultimate parent company Copies of the ultimate parent company's 2011 annual report and accounts may be obtained from the Company Secretary's Department, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN

(All amounts in £ thousands unless otherwise stated)

29 Related–party transactions

The Company s immediate parent company is Lloyds TSB General Insurance Holdings Limited The company regarded by the directors as the ultimate parent and controlling company is Lloyds Banking Group plc, a limited liability company incorporated and domiciled in Scotland, which is also the parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the Company is a member Lloyds TSB Bank plc is the parent company of the smallest such group of undertakings Copies of the group accounts of both companies may be obtained from the Company Secretary's Department, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN

The Company's related parties include parents, fellow subsidiaries, pension schemes of the Company's ultimate parent company and the Company's key management personnel Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, which is determined to be the Company's directors

Transactions with key management

There were no transactions in the normal course of business that were material to key management or the Company other than those disclosed as part of directors' remuneration as disclosed below Key management compensation comprised

	2011	**2010**
Salaries and other short-term employee benefits	1,261	592
Post-employment benefits	67	37
Share based payments	109	163
	1,437	792

The Company's share of the emoluments of its directors was £1,260,662 (2010 £591,538)

One director exercised share options this year (2010 Nil) Shares were received or receivable in respect of qualifying service under long term incentive plans by 8 directors (2010 6)

No directors are accruing retirement benefits (2010 1) under defined benefit pension schemes

The Company s share of contributions paid to money purchase pension schemes in respect of directors' qualifying services was £66,730 (2010 £36,614) The highest paid director's scheme received £3,762 (2010 £nil)

The Company's share of the emoluments of its highest paid director was £270,154 (2010 £108,877)

At the year end, the highest paid director's accrued pension totalled £nil (2010 £nil per annum), being the pension entitlement based on pensionable service with the group to 31 December 2011 but payable at normal retirement age

The emoluments of the former Chairman (A G Kane) were borne by other group undertakings

The emoluments of T E Strauss, who is a director of other Lloyds Banking Group companies, are not recharged to this Company as it is considered that his services to this Company are incidental to his other activities within the group

(All amounts in £ thousands unless otherwise stated)

29 **Related–party transactions (continued)**

Transactions with other related parties

(a) Sales of insurance contracts and purchase of other services

	2011	**2010**
Expenses for the acquisition of insurance contracts include		
- commission payable to fellow group subsidiaries	148,021	158,890
Expenses for marketing and administration include		
- services of key management personnel from fellow group subsidiary	1,437	792
- other management services from fellow group subsidiary	88,764	82,463
	90,201	83,255
- investment management services from fellow group subsidiary	491	408
	90,692	83,663
	238,713	242,553

(b) Year-end balances arising from the sales of insurance contracts and purchases of products and services

	2011	**2010**
Collective Investment Schemes		
- investment in a parent company	10,237	13,453
Debt Securities		
- investment in a fellow group subsidiary	-	3,973
Amount due from related parties (Note 8)		
- due from a parent company in respect of a 3 year fixed rate treasury deposit with an interest rate of 4 27% per annum	90,579	90,569
- due from fellow group subsidiaries in respect of insurance operations and management charges	13,293	7,014
	103,872	97,583
Amounts due to related parties		
- due to fellow group subsidiaries in respect of insurance operations and management charges (Note 15)	47,856	80,286
- due to a parent company in respect of group relief for income tax	45,221	35,214
	93,077	115,500