LLOYDS TSB GENERAL INSURANCE LIMITED

REPORT AND ACCOUNTS FOR YEAR ENDED 31 DECEMBER 2012

Registered Number:

204373

Registered Office:

25 Gresham Street,
London,
EC2V 7HN

Directors

Lord Blackwell (Chairman)
Dr N M Bryson (Deputy Chairman & Non-executive Director)
T E Strauss (Managing Director)
A M Parsons
D J Walkden
M Christophers (Non-executive Director)
M G Culmer (Non-executive Director)
M A Fisher (Non-executive Director)
J Goford (Non-executive Director)
A M Peck (Non-executive Director)
Drs C A C M Schrauwers (Non-executive Director)

Company Secretary·

S Mayer

Member of Lloyds Banking Group

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 household and domestic all risks insurance, creditor insurance, pet insurance and accident and health insurance

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

Our business model positions us to maximise the capital benefits from risk diversification available under the proposed Individual Capital Assessment Plus (ICA plus) regime and ultimately Solvency II

In preparation for the introduction of the Solvency II regime the insurance entities within Lloyds Banking Group plc's Insurance Division were restructured in 2011 to bring all relevant entities under Scottish Widows Group Limited ("SWG") As a result SWG became the holding company for the entities within the single integrated insurance business and is the ultimate insurance undertaking for solvency purposes All subsidiaries of SWG, including the Group, are now managed within an overall risk and capital management framework The capital management framework will facilitate the monitoring and allocation of capital across the entities owned by SWG, including those within the Group

In future, when Solvency II is fully implemented, it is expected that the Insurance Division of Lloyds Banking Group plc will be able to recognise the capital diversification benefits which will flow from the management of capital and risk within this overall structure Although the implementation date for Solvency II within the European Union has been deferred, the structure will enable the business to operate effectively within the transitional arrangements that have been proposed

Profit before tax reduced in the year to £120m (2011 £174m) due to the cost of significant weather events experienced throughout the year and the continued run off of the creditor book

The household book continues to grow across all three brands (Lloyds TSB, Bank of Scotland and Halifax)

Work to embed Solvency II continued throughout 2012 and the year culminated with the successful application for Internal Model Approval Process as part of the wider Insurance Group submission

The company continues to practice efficient balance sheet management with a focus on investment and liquidity management opportunities, leveraging wider Lloyds Banking Group plc's skills and capabilities During 2012 excess liquidity was invested in less liquid credit assets purchased from, or issued by, parties within Lloyds Banking Group plc through asset backed securities and covered bonds All assets were acquired at their fair value Further details on the credit risk and fair value measurement of these assets can be found in Note 4

The business strategy and focus for 2013 and beyond 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 continuing to integrate the Insurance businesses The directors consider that the Company's principal activities will continue unchanged in the foreseeable future

Results and dividends

The profit after taxation for the year ended 31 December 2012 amounted to £93m as set out in the statement of comprehensive income on page 7 (2011 £130m)

Dividends of £32m (£0 52 per share) were paid during the year in respect of 2012 (2011 £132m (£2 14 per share)) The directors do not recommend any further dividend in respect of 2012

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 increased combined ratio of 81% (2011 71%) reflects increased claims costs on the property book due to the significant weather events experienced throughout the year The directors consider that the above are the key performance indicators which are appropriate to the principal activity of the Company These, together with other metrics which cover customer, operational measures and capital, are included in the balanced scorecard which is used to measure all aspects of the performance of the business

Going Concern

The directors are satisfied that the Company has adequate resources to continue in business for the foreseeable future and consequently the going concern basis continues to be appropriate in preparing the accounts

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

	Appointed	Resigned
R Harris		29 February 2012
K P Cracknell		31 July 2012
G N Stewart	1 January 2012	5 October 2012
R J M Bulloch		31 December 2012
A M Peck	24 January 2012	
J Goford	24 January 2012	
D J Walkden	24 January 2012	
Dr N M Bryson	24 January 2012	
Dr C A C M Schrauwers	14 May 2012	
Lord N R Blackwell	1 September 2012	
M A Fisher	19 September 2012	
M G Culmer	31 October 2012	
A M Parsons	9 November 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 2012, the number of days required to be shown in this report, to comply with the provisions of the Companies Act 2006, is nil (2011 nil)

Employees

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

In the UK, Lloyds Banking Group plc belongs to the major employer groups campaigning for equality for the all staff, including Employers' Forum on Disability, Employers' Forum on Age and Stonewall Lloyds Banking Group plc is also represented on the Board of Race for Opportunity and the Equal Opportunities Commission Involvement with these organisations enables Lloyds Banking Group plc to identify and implement best practice for staff

Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys These meetings, briefings and internal communications also serve to achieve a common awareness of the financial and economic factors that affect the performance of the company 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 Further details are set out in note 27

Employees (continued)

Lloyds Banking Group plc welcomes applications from disabled persons and monitors the volume of disabled applicants on a monthly basis Should a colleague become disabled in the course of their employment training and support shall be provided to accommodate their circumstances

A whole host of training and development is provided for all colleagues including disabled persons and is monitored through the Company's training facilities and all colleagues are encouraged and supported through the use of individual learning plans

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 Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements,
- 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 (2011 nil)

Statement of disclosure of information to auditors

In so far as each director in office at the date 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 This confirmation is given and should be interpreted in accordance with the provisions of the Companies Act 2006

On behalf of the Board of Directors

A M Parsons
Director
21 March 2013

LLOYDS TSB GENERAL INSURANCE LIMITED

Registered number 204373

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 2012 which comprise the Balance Sheet, the Statement of Comprehensive Income, the Statement of Cash Flows, the Statement of Changes in Equity 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 Directors' Responsibilities Statement (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 In addition, we read all the financial and non-financial information in the Directors' Report to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

Opinion on financial statements

In our opinion the financial statements

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

Opinion on other matters 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 A Roper

David Roper (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester
21 March 2013

LLOYDS TSB GENERAL INSURANCE LIMITED

Registered number 204373

BALANCE SHEET

AS AT 31 DECEMBER 2012
(All amounts in £ thousands unless otherwise stated)

	Note	2012	2011
ASSETS			
Intangible insurance assets	5	61,411	70,614
Financial assets held at fair value through profit or loss			
Collective Investment Schemes	6,7	289,529	334,781
Debt securities	6,7	178,461	50,998
Loans and receivables including insurance receivables	7,8	243,432	337,999
Reinsurance assets	9,12	10,352	13,821
Cash and cash equivalents	10	128,921	53,068
Total assets		912,106	861,281
EQUITY AND LIABILITIES			
Equity attributable to the Company's equity holder			
Ordinary share capital	11	61,700	61,700
Retained earnings		259,088	197,989
Total equity		320,788	259,689
LIABILITIES			
Insurance contracts	12	425,895	452,584
Provisions for other liabilities and charges	13	6,604	2,578
Trade and other payables	14	65,172	79,773
Deferred income tax	15	20,514	21,436
Income tax liability		73,133	45,221
Total liabilities		591,318	601,592
Total equity and liabilities		912,106	861,281

The notes on pages 10 to 49 form an integral part of these financial statements

The financial statements were approved by the Board of Directors on 21 March 2013 and were signed on its behalf by

A M Parsons
Director

LLOYDS TSB GENERAL INSURANCE LIMITED

Registered number 204373

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2012

(All amounts in £ thousands unless otherwise stated)

	Note	2012	2011
Insurance contract premium revenue	17	572,149	586,786
Insurance contract premium ceded to reinsurers	17	(21,101)	(25,594)
Net premium revenue		551,048	561,192
Investment income	18	3,027	4,568
Net fair value gains on financial assets held at fair value through profit or loss	19	11,392	6,067
Total income		565,467	571,827
Insurance claims and loss adjustment expenses	20	(192,851)	(143,146)
Insurance claims and loss adjustment expenses recoverable from reinsurers	20	1	1
Net insurance claims		(192,850)	(143,145)
Expenses for the acquisition of insurance contracts	21	(218,461)	(197,090)
Expenses for administration	21	(34,066)	(57,214)
Total expenses		(445,377)	(397,449)
Results of operating activities and profit before income tax		120,090	174,378
Income tax expense	23	(26,991)	(44,247)
Profit for the year attributable to equity holder of the Company		93,099	130,131
Other comprehensive income for the year		-	-
Profit and total comprehensive income for the year attributable to equity holder of the Company		93,099	130,131

All the amounts above are in respect of continuing operations

The notes on pages 10 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 2012
(All amounts in £ thousands unless otherwise stated)

	Note	Attributable to the equity holder of the Company Share capital	Retained earnings	Total equity
Year ended 31 December 2011				
At beginning of year		61,700	199,858	261,558
Profit and total comprehensive income for the year attributable to equity holder for 2011		-	130,131	130,131
Dividends paid	24	-	(132,000)	(132,000)
At end of year	11	61,700	197,989	259,689
Year ended 31 December 2012				
At beginning of year		61,700	197,989	259,689
Profit and total comprehensive income for the year attributable to equity holder for 2012		-	93,099	93,099
Dividends paid	24	-	(32,000)	(32,000)
At end of year	11	61,700	259,088	320,788

Not all of the above amounts can be distributed to the equity holder of the Company due to statutory and regulatory requirements Further details are given in Note 4 5

The notes on pages 10 to 49 form an integral part of these financial statements

LLOYDS TSB GENERAL INSURANCE LIMITED

Registered number 204373

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2012
(All amounts in £ thousands unless otherwise stated)

	Note	2012	2011
Cash flows from operating activities			
Cash generated by operations	25	175,646	55,775
Income tax paid		-	(35,214)
Net cash generated by operating activities		175,646	20,561
Cash flows from investing activities			
Net (addition)/disposal of collective investment schemes, equity and debt securities		(73,024)	108,926
Interest received		3,048	4,541
Dividend and other income received		2,205	1,896
Net cash (used)/generated by investing activities		(67,771)	115,363
Cash flows from financing activities			
Dividends paid to company equity holder	24	(32,000)	(132,000)
Net cash used by financing activities		(32,000)	(132,000)
Net increase in cash and cash equivalents		75,875	3,924
Cash and cash equivalents at beginning of year	10	53,016	49,092
Cash and cash equivalents at end of year	10	128,891	53,016

The notes on pages 10 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, pet insurance and accident and health insurance marketed primarily under the Lloyds TSB, Bank of Scotland and Halifax brands 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 endorsed by the EU and in accordance with those sections of the Companies Act 2006 applicable under IFRS 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 profit or loss

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

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

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 2012 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 on or after 1 January 2012 and not early adopted

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

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

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

Changes in accounting policy and disclosures (continued)

(b) New standards and interpretations not yet adopted (continued)

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

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

(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 an unlisted company (wholly-owned by Lloyds Banking Group plc), the Company is not required 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 profit or loss 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 profit or loss

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

Financial assets designated as at fair value through profit or loss 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 profit or loss 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 including insurance 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 Receivables arising from insurance contracts are also classified in this category Loans and receivables are included in Loans and receivables including insurance 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 of financial assets, or
- national or local economic conditions that correlate with defaults on the assets in the group of financial assets

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 The Company defines significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event which are significantly more than the benefits payable if the insured event were 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, accident and health, and pet

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

Pet insurance contracts mainly compensate the Company's customers against the cost to the insured of their pet sustaining an injury or suffering sickness or infirmity and incurring veterinary fees It also provides compensation for theft or death of the animal

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 Her Majesty s Revenue & Customs (HMRC) 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 premium reserve

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

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 substantively enacted 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 14) 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 profit or loss'

Net investment gains and losses on financial assets held at fair value through profit or loss include both realised and unrealised gains and losses Movements are recognised in the Statement of Comprehensive Income in the period in which they arise

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 Trade payables are initially recognised at fair value and subsequently held at amortised cost

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

Unemployment claims during the year have continued to fall from their peak in 2009, though remain higher than prior to the recession and reporting and payment patterns have been disrupted by this, by process changes and by the creditor book now being in run-off The prevailing economic conditions are also expected to continue to produce a secondary, though smaller impact 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 £13 417m net of reinsurance (2011 £16 041m) Similarly, an increase of 10% in the number of all claims would result in the recognition of an additional cost of £14 711m net of reinsurance (2011 £17 317m) A 5% increase in the inflation rate of claims would result in the recognition of an additional cost of £5 938m net of reinsurance (2011 £5 690m)

4 Risk management

The insurance businesses are managed together as part of the Lloyds Banking Group One Insurance Division, as such risk is managed across all of the insurance companies and not at the individual company level

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 Insurance Risk Committee which comprises members of the Insurance Executive 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 £676 3m is £92 9m across Lloyds Banking Group General Insurance (2011 £767 1m is £85 2m across Lloyds Banking Group General Insurance) The Company has discontinued the aggregate loss cover purchased in 2011 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 12

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 of recurring claims 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 (2011 £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 12

4 **Risk management (continued)**

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 investment proceeds are not sufficient to fund the obligations arising from its insurance contracts The most important components of financial risk are market risk (primarily interest rate risk), credit risk and liquidity risk

To manage these risks, the Company has a defined investment policy which sets out limits on the Company's exposure to its investments 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

4.3.1 Market risk

Market risk is the risk of reduction in earnings and/or value from unfavourable market movements This risk typically arises from fluctuations in market interest rates (interest rate risk) and market price (price risk), whether such changes are caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market

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

The Company is exposed to market risk (including interest rate risk) through its portfolio of investments, the majority of which are short term in nature The Company categorises its financial assets at fair value through profit or loss as follows

- Collective investment schemes unlisted investments which are authorised and regulated by the Financial Services Authority and fall under the EU directive on Undertakings for Collective Investment in Transferable Securities,
- Listed debt securities includes sterling denominated floating rate notes, and
- Unlisted debt securities asset backed securities and covered bonds which are not actively traded and are valued using a discounted cash flow model

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 because the majority of assets as well as liabilities are of a short term nature

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 2012 was £16 6m (2011 £5 5m) The VaR has increased due to the impact of purchasing unlisted debt securities during the year

(a) Interest rate risk

Interest rate risk is the risk that the value of future cash flows of a financial instrument will fluctuate because of changes in interest rates and the shape of the yield curve

The Company underwrites predominantly short-term insurance liabilities with durations of 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

	2012	**2011**
A change of interest rate by +/- 1% would have the following effect on the value of the Company's investments	-/+ £0 3m	-/+ £0 3m

(All amounts in £ thousands unless otherwise stated)

4 **Risk management (continued)**

4 3 1 Market risk (continued)

(b) Price Risk

The Company's price risk exposure relates to financial instruments whose values will fluctuate as a result of changes in market prices, or as a result of changes to assumptions in pricing models when these are used to value instruments which are not actively traded

Such changes in market values or pricing model valuations of a financial instrument can arise from factors specific to the individual instrument or its issuer 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 financial instruments 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

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

2012

	Insurance contracts	Other financial assets & liabilities	Other assets & liabilities	Total
Intangible insurance assets	61,411	-	-	61,411
Financial assets held at fair value through profit or loss				
Collective Investment Schemes – unlisted	69,878	219,651	-	289,529
Debt securities – unlisted	-	178,461	-	178,461
Insurance receivables	243,316	-	-	243,316
Other receivables	-	116	-	116
Reinsurance assets	10,352	-	-	10,352
Cash and cash equivalents	59,570	69,351	-	128,921
	444,527	467,579	-	912,106
Insurance contracts and payables	425,895	-	-	425,895
Provisions for other liabilities and charges	-	-	6,604	6,604
Trade and other liabilities	18,632	36,856	9,684	65,172
Deferred income tax	-	-	20,514	20,514
Income tax liability	-	-	73,133	73,133
	444,527	36,856	109,935	591,318

(All amounts in £ thousands unless otherwise stated)

4 **Risk management (continued)**

4 3.1 Market risk (continued)

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 profit or loss				
Collective Investment Scheme - 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

In 2012 a related party balance within other loans and receivables of £14 945m (2011 £13 293m) has been reclassified as a related party balance within receivables arising from insurance and reinsurance contracts to align with other Group entities to provide a clearer presentation The prior year numbers have not been restated for this presentation

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 profit or loss 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

(a) Reinsurance credit risk

The Company's risk transfer policy addresses the management of reinsurance credit risk and is authorised by the Insurance Finance Capital Committee (IFCC) 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 actuarial function by the reinsurance broker The Company's actuarial function monitors the status of claims made on reinsurance policies

(All amounts in £ thousands unless otherwise stated)

4 **Risk management (continued)**

4 3.2 Credit risk (continued)

(b) 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 Insurance Shareholder Investment Management Committee (ISIM) 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 In line with Company strategy to increase investment returns whilst maintaining an acceptable level of credit risk, the Company purchased unlisted debt securities during the year The Company continues to take a prudent and cautious approach to investment The table below shows the Company's financial assets held at fair value through profit or loss split by credit rating using Moody's or equivalent

Financial assets held at fair value through profit or loss:	**2012**	**2011**
Debt securities – listed (Note 7)		
AA	-	44,979
A	-	6,019
Debt securities – unlisted		
AAA	178,461	-
Total assets bearing credit risk	178,461	50,998
Collective Investment Schemes - unlisted		
AAA	231,385	281,233
Unrated	58,144	53,548
	289,529	334,781

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

All remaining listed debt securities matured during the year The investment in collective investment schemes was reduced during the year as funds were withdrawn from the Investment Cash Fund which has an 'AAA' credit rating and invested in unlisted debt securities which also all have 'AAA' credit ratings The unrated collective investment scheme is an Absolute Return Bond Fund

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 primarily 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 Company also holds unlisted debt securities which have maturities of longer term duration (3–5 years maximum) The Company routinely reviews its capital and liquidity position and only invests excess liquidity (where balances exceed a level required to settle insurance claims and other creditors including an internal buffer) in longer term assets As such the assets do not carry any significant liquidity risk

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 as permitted by IFRS 4 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

(All amounts in £ thousands unless otherwise stated)

4 **Risk management (continued)**

4 3 3 Liquidity risk (continued)

	Up to 3 months	Between 3 and 12 months	Between 1 and 2 years	Over 2 years	Total
At 31 December 2012					
Short-term insurance contracts	61,854	65,611	19,018	12,450	158,933
Trade and other payables	55,488	-	-	-	55,488
	117,342	65,611	19,018	12,450	214,421
At 31 December 2011					
Short-term insurance contracts	62,257	76,125	29,595	7,593	175,570
Trade and other payables	67,662	-	-	-	67,662
	129,919	76,125	29,595	7,593	243,232

Short-term insurance contracts include claims reported and loss adjustment expenses, claims incurred but not reported and unexpired risk reserve See Note 12

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

- *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

4 **Risk management (continued)**

4 3.4 Operational risk (continued)

- *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

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 Scenario Analysis

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 Operational Risk Committee where any particular concerns may be escalated further to the division or group risk functions

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

Conduct Risk
The risk of regulatory censure and/or a reduction in earnings/value, through financial or reputational loss, from inappropriate or poor customer outcomes Associated risks include poor product design and development, customer advice, customer service and customer complaint handling

Customer treatment and how Lloyds Banking Group as a whole manages its customer relationships affects all aspects of the Group's operations and is closely aligned with achievement of Lloyds Banking Group's strategic vision to be the best bank for customers There remains a high level of scrutiny regarding the treatment of customers by financial institutions from regulatory bodies, the press and politicians

Conduct risk is centrally managed by Lloyds Banking Group on behalf of the Company

(All amounts in £ thousands unless otherwise stated)

4 **Risk management (continued)**

4.3.5 Political risk and uncertainties

Political risk is the risk of reductions in earnings and/or value through financial loss from a changing political environment In the absence of a definitive, agreed and fully-implemented solution to the Eurozone crisis there continues to be some risk that ongoing economic uncertainty in Europe and the availability of credit could cause a return to recession in the United Kingdom and Ireland

A Scottish Independence referendum is due to be held in 2014 A Lloyds Banking Group Scottish Constitutional Change Steering Group, with cross-Group representation, has been set up to assess any potential impact for the business

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, all the collective investment schemes in which the Company has invested have a price in an active market and are therefore 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 the Company's listed debt securities, which are all 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 The Company's unlisted debt securities are all classified as level 3

The unlisted debt securities are not actively traded and are valued using a discounted cash flow model The valuation incorporates credit risk spreads, which are generally based on observable spreads on similar securities, plus a liquidity premium Assumptions are made about the expected life of the securities, reflecting prepayment behaviour The effect of applying reasonably possible alternative assumptions to the value of these unlisted debt securities would be to decrease the fair value by £1 8m (2011 £nil) or increase it by £2 8m (2011 £nil)

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 2012

At 31 December 2012	Level 1	Level 2	Level 3	Total
Financial assets held at fair value through profit or loss				
Collective Investment Scheme – unlisted	289,529	-	-	289,529
Debt securities – unlisted	-	-	178,461	178,461
	289,529	-	178,461	467,990

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

(All amounts in £ thousands unless otherwise stated)

4 **Risk management (continued)**

4 4 **Fair value hierarchy of financial assets (continued)**

The table below shows movements in the assets measured at fair value based on valuation techniques for which any significant input is not based on observable market data (level 3 only)

	2012	2011
At 1 January	-	-
Net gains recognised within net fair value gains on financial assets held at fair value through profit or loss in the statement of comprehensive income	742	-
Additions	179,778	-
Disposals	(2,059)	-
At 31 December	178,461	-
Total gains for the period included in the statement of comprehensive income for assets held at 31 December	676	-

4 5 **Capital risk management**

The Company's objectives when managing capital are
- to have sufficient further capital to safeguard the Company's ability to continue as a going concern so that it can continue to provide returns for the shareholder and benefits for other stakeholders, and
- to comply with the insurance capital requirements set out by the FSA in the UK

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

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 equalisation reserve which is shown in this note below

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

Retained earnings represent the amount available for dividend distribution to the equity shareholder of the Company except for £12 2m (2011 £6 3m) unrealised gains on financial assets held at fair value which is not distributable and £68 7m (2011 £64 3m) 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 can be utilised 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)

5 Intangible insurance assets

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

Deferred acquisition costs	**2012**	**2011**
At 1 January	70,614	83,909
Additions	209,258	183,795
Amortisation through income (Note 21)	(218,461)	(197,090)
At 31 December	61,411	70,614
Realisable within one year	61,238	68,985
Realisable after one year	173	1,629

In 2012 marketing and certain other expenses of £30 541m (2011 £29 658m) have been reclassified from "Expenses for administration' (which has been re-named from the previous title of "Expenses for marketing and administration' accordingly) to Expenses for the acquisition of insurance contracts' to align with other Group entities to provide a clearer presentation 'Additions' and "Amortisation through income" above have increased accordingly The prior year numbers have not been restated for this presentation

6 Financial instruments by category

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

31 December 2012	**Financial assets at fair value through profit or loss**	**Loans and receivables**	**Total**
Assets			
Financial assets at fair value through profit or loss			
Collective Investment Schemes – unlisted	289,529	-	289,529
Debt securities – unlisted	178,461	-	178,461
Amounts due from related parties	-	14,945	14,945
Cash and cash equivalents	-	128,921	128,921
Total	467,990	143,866	611,856

	Other liabilities at amortised cost	**Total**
Liabilities		
Trade and other payables	36,856	36,856
Total	36,856	36,856

31 December 2011	**Financial assets at fair value through profit or loss**	**Loans and receivables**	**Total**
Assets			
Financial assets at fair value through profit or loss			
Collective Investment Scheme – 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)

7 Financial assets

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

	2012	2011
Fair value through profit or loss		
Collective Investment Schemes – unlisted	289,529	334,781
Debt securities – listed	-	50,998
Debt securities – unlisted	178,461	-
Total financial assets held at fair value through profit or loss	467,990	385,779
Loans and receivables including insurance receivables (Note 8)	243,432	337,999
Cash and cash equivalents	128,921	53,068
Total financial assets	840,343	776,846
Available within one year	662,134	776,846
Available after one year	178,209	-

The movements on financial assets held at fair value through profit or loss are detailed below

	2012	2011
At 1 January	385,779	490,534
Fair value net gains (excluding net realised gains and losses)	7,670	2,849
Additions	215,838	40,298
Disposals (sale and redemptions)	(141,297)	(147,902)
At 31 December	467,990	385,779

8 Loans and receivables including insurance receivables

	2012	2011
Receivables arising from insurance and reinsurance contracts		
- due from contract holders	228,371	234,106
- due from related parties (Note 28)	14,945	-
Other loans and receivables		
- due from related parties (Note 28)	-	103,872
Prepayments	116	21
Total loans and receivables including insurance receivables	243,432	337,999
Available within one year	243,432	337,999

As at 31 December 2012 all overdue loans and receivables arising from insurance contracts were provided for in full

In 2012 a related party balance within other loans and receivables of £14 945m (2011 £13 293m) has been reclassified as a related party balance within receivables arising from insurance and reinsurance contracts to align with other Group entities to provide a clearer presentation The prior year numbers have not been restated for this presentation

(All amounts in £ thousands unless otherwise stated)

9 Reinsurance assets

	2012	2011
Reinsurers unearned premium	9,737	12,455
Reinsurers' share of claims reserves	615	1,366
Reinsurance assets	10,352	13,821
Available less than one year	10,180	12,987
Available greater than one year	172	834

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

10 Cash and cash equivalents

	2012	2011
Cash at bank and in hand	69,321	52,794
Global Liquidity Fund	59,570	222
Total cash and cash equivalents for cash flow purposes	128,891	53,016
Accrued interest	30	52
Total cash and cash equivalents	128,921	53,068

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 profit or loss, is managed by a related party and in 2012 has been classified as a related party balance (Note 28)

Included in cash and cash equivalents are bank accounts totalling £69 343m (2011 £52 751m) placed with a parent company (Note 28)

The effective interest rate on cash and cash equivalents was 0 79% (2011 0 80%)

11 Share capital

	2012	2011
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 (2011 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

(All amounts in £ thousands unless otherwise stated)

12 **Insurance liabilities and reinsurance assets**

	2012	2011
Gross		
Short-term insurance contracts		
- claims reported and loss adjustment expenses	128,392	143,240
- claims incurred but not reported	19,340	29,930
- unexpired risk reserve	11,201	2,400
- unearned premiums	266,962	277,014
Total insurance liabilities - gross	425,895	452,584
Recoverable from reinsurers		
Short-term insurance contracts		
- claims reported	615	1,366
- claims incurred but not reported	-	-
- unexpired risk reserve	-	-
- unearned premiums	9,737	12,455
Total reinsurers' share of insurance liabilities	10,352	13,821
Net		
Short-term insurance contracts		
- claims reported and loss adjustment expenses	127,777	141,874
- claims incurred but not reported	19,340	29,930
- unexpired risk reserve	11,201	2,400
- unearned premiums	257,225	264,559
Total insurance liabilities – net	415,543	438,763
Payable within one year	383,823	398,494
Payable after more than one year	31,720	40,269

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 2012 and 2011 are not material

The unexpired risk reserve includes £8 8m (2011 £nil) in respect of the pet insurance business

12 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

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

12 1 **Short-term insurance contracts – assumptions, changes in assumptions and sensitivity (continued)**

12 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

12 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 (2011 £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)

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

12 1 **Short-term insurance contracts – assumptions, changes in assumptions and sensitivity (continued)**

12 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	**2008**	**2009**	**2010**	**2011**	**2012**	**Total**
Estimate of ultimate claims costs						
- at end of accident year	151,107	161,951	174,685	139,803	174,854	802,400
- one year later	146,736	153,194	168,892	130,133	-	-
- two years later	145,667	138,663	164,937	-	-	-
- three years later	138,908	137,344	-	-	-	-
- four years later	138,434	-	-	-	-	-
Current estimate of cumulative claims	138,434	137,344	164,937	130,133	174,854	745,702
Cumulative payments to date	(135,952)	(134,536)	(158,238)	(115,094)	(101,139)	(644,959)
Liability recognised in the balance sheet	2,482	2,808	6,699	15,039	73,715	100,743
Liability in respect of prior years						4,465
Total gross liability included in the balance sheet						105,208

Household and domestic all risks - net						
Accident year	**2008**	**2009**	**2010**	**2011**	**2012**	**Total**
Estimate of ultimate claims costs						
- at end of accident year	151,107	161,951	174,685	139,803	174,854	802,400
- one year later	146,736	153,194	168,892	130,133	-	-
- two years later	145,667	138,663	164,937	-	-	-
- three years later	138,908	137,344	-	-	-	-
- four years later	138,434	-	-	-	-	-
Current estimate of cumulative claims	138,434	137,344	164,937	130,133	174,854	745,702
Cumulative payments to date	(135,952)	(134,536)	(158,238)	(115,094)	(101,139)	(644,959)
Liability recognised in the balance sheet	2,482	2,808	6,699	15,039	73,715	100,743
Liability in respect of prior years						3,850
Total net liability included in the balance sheet						104,593

As at the year ended 31 December 2012 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 reinsurance programme was renewed on 1 July 2012, with the only change in nature from the previous year being the discontinuation of aggregate loss cover purchased in 2011 to mitigate the effect of multiple events 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 £105 208m and net liability of £104 593m shown in the above tables exclude £9 523m of unallocated claims handling expenses.

(All amounts in £ thousands unless otherwise stated)

12 Insurance liabilities and reinsurance assets (continued)

12 1 Short-term insurance contracts – assumptions, changes in assumptions and sensitivity (continued)

12.1.3 Claims development tables (continued)

Creditor – gross and net **Accident year**	**2008**	**2009**	**2010**	**2011**	**2012**	**Total**
Estimate of ultimate claims costs						
- at end of accident year	52,607	99,120	70,832	44,112	18,343	285,014
- one year later	51,357	82,879	45,386	24,500	-	-
- two years later	48,730	75,871	41,773	-	-	-
- three years later	47,153	69,211	-	-	-	-
- four years later	46,711	-	-	-	-	-
Current estimate of cumulative claims	46,711	69,211	41,773	24,500	18,343	200,538
Cumulative payments to date	(45,963)	(65,320)	(36,614)	(19,851)	(4,854)	(172,602)
Liability recognised in the balance sheet	748	3,891	5,159	4,649	13,489	27,936
Liability in respect of prior years						423
Total liability included in the balance sheet						28,359

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 £28 359m shown in the above table excludes £3 414m of unallocated claims handling expenses

12 2 Movements in insurance liabilities and reinsurance assets

(a) Claims and loss adjustment expenses

	2012			**2011**		
	Gross	**Reinsurance**	**Net**	**Gross**	**Reinsurance**	**Net**
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 beginning of year	173,170	(1,366)	171,804	261,493	(1,655)	259,838
Cash paid for claims settled in the year	(209,488)	752	(208,736)	(229,069)	290	(228,779)
Increase in liabilities (see Note 20)						
- arising from current year claims	225,922	-	225,922	209,844	-	209,844
- arising from prior year claims	(41,872)	(1)	(41,873)	(69,098)	(1)	(69,099)
Total at end of year	147,732	(615)	147,117	173,170	(1,366)	171,804
Notified claims	128,392	(615)	127,777	143,240	(1,366)	141,874
Incurred but not reported	19,340	-	19,340	29,930	-	29,930
Total at end of year	147,732	(615)	147,117	173,170	(1,366)	171,804

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 12 1 2

(All amounts in £ thousands unless otherwise stated)

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

12 2 **Movements in insurance liabilities and reinsurance assets (continued)**

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

	2012			2011		
	Gross	**Reinsurance**	**Net**	**Gross**	**Reinsurance**	**Net**
Unearned premiums						
At 1 January	277,014	(12,455)	264,559	304,298	(10,447)	293,851
Increase in the year (see Note 17)	562,097	(18,383)	543,714	559,502	(27,602)	531,900
Release in the year (see Note 17)	(572,149)	21,101	(551,048)	(586,786)	25,594	(561,192)
At 31 December	266,962	(9,737)	257,225	277,014	(12,455)	264,559
Unexpired risk reserve						
At 1 January	2,400	-	2,400	-	-	-
Increase in the year (see Note 20)	9,174	-	9,174	2,400	-	2,400
Release in the year (see Note 20)	(373)	-	(373)	-	-	-
At 31 December	11,201	-	11,201	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

13 **Provision for other liabilities and charges**

	Premium Rebates	**FSCS Levy**	**Total**
At 1 January 2012	1,752	826	2,578
Used during the year	(7,482)	(729)	(8,211)
Statement of comprehensive income charge			
- additional provisions	4,952	1,652	6,604
- under/(over) provision from prior years	5,730	(97)	5,633
At 31 December 2012	4,952	1,652	6,604

	2012 Total	2011 Total
Current	4,804	2,578
Non-current	1,800	-

(a) Premium Rebates

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

(All amounts in £ thousands unless otherwise stated)

13 **Provision for other liabilities and charges (continued)**

(b) 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 2013 to finalise its levy in respect of its financial year 2012/13, and 31 March 2014 in respect of 2013/14 It is not anticipated that any further levy will be raised for 2012/13 The maximum levy which can be raised is estimated to be £12 5m for the 2012 basis year The FSCS has issued its Plan and Budget for 2013/14 and a provision of £1 7m in respect of this levy is held in these financial statements

14 **Trade and other payables**

	2012	**2011**
Due to related parties (Note 28)	37,508	47,856
Insurance payables	18,632	20,968
Other payables and accrued expenses	1,599	1,804
Other taxes payable	7,433	9,145
At 31 December	65,172	79,773
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 16)	2,251	2,966

All trade and other payables are current liabilities

15 **Deferred income tax**

Deferred income tax is calculated in full on temporary differences under the liability method using a tax rate of 23% (2011 25%)

On 21 March 2012, the Government announced a reduction in the rate of corporation tax to 24% with effect from 1 April 2012 The reduction was enacted under the Provisional Collection of Taxes Act 1968 on 26 March 2012 In addition, the Finance Act 2012, which passed into law on 3 July 2012, included legislation to reduce the main rate of corporation tax from 24% to 23% with effect from 1 April 2013 The change in the main rate of corporation tax from 25% to 23% has resulted in a reduction in the Company's net deferred tax liability at 31 December 2012 of £1 767m comprising a £1 767m credit included in the income statement

The proposed further reduction in the rate of corporation tax by 2% to 21% from 1 April 2014 is expected to be enacted during 2013 The proposed further reduction in the rate of corporation tax to 20% by 1 April 2015 is expected to be enacted during 2014 The effect of these further changes upon the Company's deferred tax balances cannot be reliably quantified at this stage

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

	2012	**2011**
At 1 January	21,436	22,410
Statement of comprehensive income credit (Note 23)	(922)	(974)
At 31 December	20,514	21,436

(All amounts in £ thousands unless otherwise stated)

15 **Deferred income tax (continued)**

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 2011	(2)	(2)
Statement of comprehensive income charge during 2011	-	-
At 31 December 2011	(2)	(2)
Statement of comprehensive income charge during 2012	2	2
At 31 December 2012	-	-

(b) Deferred tax liabilities

	Equalisation reserve and other differences	Total
At 1 January 2011	22,412	22,412
Statement of comprehensive income charge during 2011	728	728
Change in tax rate	(1,702)	(1,702)
At 31 December 2011	21,438	21,438
Statement of comprehensive income charge during 2012	843	843
Change in tax rate	(1,767)	(1,767)
At 31 December 2012	20,514	20,514

The net deferred tax provision at 31 December 2012 was £20 514m (2011 £21 436m)

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

16 **Retirement benefit obligations**

The Company does not directly employ staff However, the Company's share of costs relating to the Group's defined benefit and defined contribution 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 14 and 28)

Full details can be found in the 2012 annual report and accounts of the Company's ultimate parent company Copies of the ultimate parent company's 2012 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)

17 Net premium revenue

	2012	2011
Short-term insurance contracts		
- premiums receivable	562,097	559,502
- change in unearned premium reserve	10,052	27,284
Premium revenue arising from insurance contracts issued	572,149	586,786
Short-term reinsurance contracts		
- premiums payable	(18,383)	(27,602)
- change in unearned premium reserve	(2,718)	2,008
Premium revenue ceded to reinsurers on insurance contracts issued	(21,101)	(25,594)
Net premium revenue	551,048	561,192

18 Investment income

	2012	2011
Interest income	2,295	3,843
Cash and cash equivalents interest income	732	725
	3,027	4,568

Included in investment income is £2 912m (2011 £4 452m) income from accounts placed with a parent company

Included in investment income is £0 080m (2011 £0 042m) income from the Global Liquidity Fund which has been classified as a related party balance in 2012 (Note 28)

19 Net fair value gains/(losses) on assets held at fair value through profit or loss

	2012	2011
Net fair value gains/(losses) on assets held at fair value through profit or loss		
- fair value gains	11,394	6,557
- fair value losses	(2)	(490)
	11,392	6,067

Fair value gains include gains arising from interest of £1 037m (2011 £0 808m) and dividends of £1 280m (2011 £0 988m) on financial assets held at fair value through profit or loss Net fair value gains/(losses) on assets held at fair value through profit or loss include net realised gains of £2 812m (2011 £2 312m) and net unrealised gains of £6 252m (2011 £1 876m)

Net fair value gains/(losses) on assets held at fair value through profit or loss do not include any net gains (2011 £0 029m) or interest income (2011 £0 033m) 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 28) as it matured on 7 December 2011

Net fair value gains/(losses) on assets held at fair value through profit or loss includes net gains of £0 079m (2011 £nil) and interest income of £0 050m (2011 £nil) in respect of an investment held in a Covered Bond issued by a fellow group subsidiary

(All amounts in £ thousands unless otherwise stated)

20 **Insurance claims and loss adjustment expenses**

	2012			2011		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
Current year claims and loss adjustment expenses	225,922	-	225,922	209,844	-	209,844
Movement in costs of prior year claims and loss adjustment expenses	(41,872)	(1)	(41,873)	(69,098)	(1)	(69,099)
Movement in the expected cost of claims for unexpired risks	8,801	-	8,801	2,400	-	2,400
Total claims and loss adjustment expenses	192,851	(1)	192,850	143,146	(1)	143,145

21 **Expenses by nature**

	2012	2011
Employee benefit expense (Note 22)	38,670	37,843
Software and other IT costs	21,959	21,666
Auditor's remuneration		
- Statutory Audit	187	100
- Non-audit services pursuant to regulation	28	28
Investment management fees	469	491
Other costs	38,094	36,503
	99,407	96,631
Allocation of claims handling expenses	(34,800)	(34,219)
Allocation of acquisition expenses	(30,541)	(5,198)
Expenses for administration	34,066	57,214
Fees and commissions payable	178,717	178,597
Acquisition expenses	30,541	5,198
Change in gross deferred acquisition costs	9,203	13,295
Expenses for the acquisition of insurance contracts	218,461	197,090
	252,527	254,304

Expenses consist of costs incurred directly by the Company and costs recharged to / from fellow group subsidiaries (Note 28)

In 2012 marketing and certain other expenses of £30 541m (2011 £29 658m) have been reclassified from "Expenses for administration (which has been re-named from the previous title of "Expenses for marketing and administration" accordingly) to "Expenses for the acquisition of insurance contracts" to align with other Group entities to provide a clearer presentation The prior year numbers have not been restated for this presentation

(All amounts in £ thousands unless otherwise stated)

22 Employee benefit expense

	2012	2011
Wages and salaries	24,148	25,452
Social security costs	2,972	3,151
Pension costs (Note 16)	3,046	2,241
Share based payments (Note 27)	630	678
Other staff costs	7,874	6,321
	38,670	37,843

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 21)

Included in the pension costs charge above is an amount of £0 953m (2011 £0 202m) representing the Company's share of retirement benefit obligations under IAS 19, of the Group's defined benefit pension schemes (Note 16), the balance of the pension costs relate to defined contribution schemes

The monthly average number of staff during the year was as follows

	2012	2011
Administration and finance	683	772
Underwriting	22	27
Claims	349	325
	1,054	1,124

23 Income tax expense

	2012	2011
Current income tax		
- current year	27,915	45,221
- prior years	(2)	-
	27,913	45,221
Deferred tax credit (Note 15)	(922)	(974)
	26,991	44,247

The charge for income taxation on the profit for the year is based on an effective United Kingdom corporation taxation rate of 24 5% (2011 26 5%) as the standard corporation taxation rate changed from 26% to 24% effective 1 April 2012

The effective tax rate for the year is 22 5% (2011 25 4%)

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

	2012	2011
Profit before tax	120,090	174,378
Tax charge at effective UK corporation tax rate of 24 5% (2011 26 5%)	29,423	46,210
Non-taxable income	(313)	(261)
Effect of reduction in deferred tax rate to 23% (2011 25%)	(1,767)	(1,702)
Additional tax deduction on loans acquired under group continuity rules	(352)	-
Tax charge for the year	26,991	44,247

(All amounts in £ thousands unless otherwise stated)

24 **Dividend per share**

The Board of Directors approved total dividends payable to Lloyds TSB General Insurance Holdings Limited of £32m (£0 52 per share) during the year in respect of 2012 (2011 £132m (£2 14 per share))

The directors do not recommend any further dividend in respect of 2012

25 **Cash generated by operations**

	2012	2011
Cash flow from operating activities		
Profit before income tax	120,090	174,378
Adjustments for		
Investment income and net fair value gains on assets held at fair value through profit or loss	(14,419)	(10,635)
	105,671	163,743
Decrease in intangible insurance assets	9,203	13,295
Decrease in loans and receivables including insurance receivables	94,567	12,477
Decrease in insurance contract liabilities (net)	(23,220)	(114,926)
Increase in provisions for other liabilities and charges	4,026	1,391
Decrease in trade and other payables	(14,601)	(20,205)
Cash generated by operations	175,646	55,775

26 **Contingencies and commitments**

Except as stated in Note 13, in the opinion of the directors, there were no material contingent liabilities or commitments requiring disclosure (2011 £nil)

27 **Share based payments**

During the year ended 31 December 2012, 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 March 2004 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

Performance conditions for executive options

For options granted in 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

27 **Share based payments (continued)**

Executive share option scheme (continued)

For options granted in 2004 (continued)

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

For options granted in 2005

The same conditions apply as for grants made in 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 plc was ranked in the top four places of the comparator group A sliding scale applied between fourth and eighth positions If Lloyds Banking Group plc 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

27 **Share based payments (continued)**

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

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

i Earnings per share (EPS) relevant to 50 per cent of the award Performance was 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 was measured based on the extent to which cumulative EP targets were achieved over the three-year period

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

i Synergy Savings The release of 50 per cent of the shares was 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 was broken down into three equally weighted annual tranches Performance was 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 were achieved determined the proportion of shares to be banked each year Any release of shares was 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 was 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 was broken down into three equally weighted tranches The tranches were 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

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

i EPS relevant to 50 per cent of the award Performance was 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 was 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

27 **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 September 2012 are as follows

i EP relevant to 30 per cent of the award The performance target is based on 2014 adjusted EP outcome

ii Absolute Total Shareholder Return (ATSR) relevant to 30 per cent of the award Performance will be measured against the annualised return over the three year period ending 31 December 2014

iii Short-term funding as a % of total funding relevant to 10 per cent of the award Performance will be measured relative to 2014 targets

iv Non-core assets at the end of 2014 relevant to 10 per cent of the award Performance will be measured by reference to balance sheet non core assets at 31 December 2014

v Net simplification benefits relevant to 10 per cent of the award Performance will be measured by reference to the run rate achieved by the end of 2014

vi Customer satisfaction relevant to 10 per cent of the award Performance will be measured by reference to the total number of FSA reportable complaints per 1,000 customers over the three year period to 31 December 2014

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

(All amounts in £ thousands unless otherwise stated)

27 **Share based payments (continued)**

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 2012 annual report and accounts of the Company's ultimate parent company Copies of the ultimate parent company's 2012 annual report and accounts may be obtained from the Company Secretary's Department, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN

28 **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 Banking Group plc financial statements in which the Company is consolidated can 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

Certain members of key management in the Company, including the highest paid director, provide services to other companies within the Lloyds Banking Group In such cases, for the purposes of this note, figures have been included based on an apportionment to the Company of the total compensation earned

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

	2012	**2011**
Salaries and other short-term employee benefits	483	1,261
Post-employment benefits	27	67
Share based payments	75	109
Termination benefits	32	-
	617	1,437

(All amounts in £ thousands unless otherwise stated)

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

Transactions with key management (continued)

The Company's share of the emoluments of its directors was £483,236 (2011 £1,260,662)

Four directors exercised share options during the year (2011 1) Shares were received or receivable in respect of qualifying service under long term incentive plans by 11 directors (2011 8)

Retirement benefits are accruing to 15 directors (2011 7) under the defined contribution scheme and nil directors (2011 nil) under defined benefit pension schemes

The Company's share of contributions paid to money purchase pension schemes in respect of directors' qualifying services was £26,841 (2011 £66,730) The highest paid director's scheme received £12,512 (2011 £3,762)

The Company's share of the emoluments of its highest paid director was £91,477 (2011 £270,154)

The highest paid director did not exercise share options in 2012 (2011 nil)

At the year end, the highest paid director's accrued pension totalled £nil (2011 £nil per annum), being the pension entitlement based on pensionable service with the group to 31 December 2012 but payable at normal retirement age

During the year £128,000 was paid to directors as compensation for loss of office The Company's share of this cost was £32,000

The emoluments of M G Culmer and M A Fisher are not recharged to this Company as it is considered that their services to this Company are incidental to their other activities within the group

Transactions with other related parties

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

	2012	**2011**
Investment Income (Note 18)		
- income from a parent company	2,912	4,452
- income from a fellow group subsidiary	80	-
	2,992	4,452
Net fair value gains/(losses) on assets held at fair value through profit or loss (Note 19)		
- net gains in respect of debt securities (listed) issued by a fellow group subsidiary which matured on 7 December 2011	-	62
- net gains in respect of debt securities (unlisted) issued by a fellow group subsidiary	129	-
	129	62
Expenses for the acquisition of insurance contracts include		
- commission payable to fellow group subsidiaries	92,952	148,021
Expenses for administration include		
- services of key management personnel from fellow group subsidiary	585	1,437
- other management services from fellow group subsidiary	84,283	88,764
	84,868	90,201
- investment management services from fellow group subsidiary	469	491
	85,337	90,692
Dividend (Note 24)		
- paid to immediate parent company	32,000	132,000

(All amounts in £ thousands unless otherwise stated)

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

Transactions with other related parties

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

	2012	2011
Collective Investment Schemes		
- investment in a parent company	3,364	10,237
Debt Securities		
- investment in a fellow group subsidiary	36,107	-
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 which matured in August 2012	-	90,579
- due from fellow group subsidiaries in respect of insurance operations and management charges	14,945	13,293
	14,945	103,872
Cash and cash equivalents (Note 10)		
- due from a parent company	69,343	52,751
- due from a fellow group subsidiary	59,570	-
	128,913	52,751
Amounts due to related parties		
- due to fellow group subsidiaries in respect of insurance operations and management charges (Note 14)	37,508	47,856
- due to a parent company in respect of group relief for income tax	73,133	45,221
	110,641	93,077