

LLOYDS BANK GENERAL INSURANCE LIMITED

(FORMERLY LLOYDS TSB GENERAL INSURANCE LIMITED)

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2013

Member of Lloyds Banking Group plc



CONTENTS

Company Information	3
Strategic Report	4-6
Directors' Report	7-8
Independent Auditors' Report to the Members of Lloyds Bank General Insurance Limited	9-10
Statement of Comprehensive Income for the year ended 31 December 2013	11
Balance Sheet as at 31 December 2013	12
Statement of Cash Flows for the year ended 31 December 2013	13
Statement of Changes in Equity for the year ended 31 December 2013	14
Notes to the Financial Statements for the year ended 31 December 2013	15-48

COMPANY INFORMATION

Board of Directors

Lord Blackwell (Chairman)

Dr N M Bryson
M Christophers
M G Culmer
M A Fisher
J Goford
V Maru
A M Parsons*
Drs C A C M Schrauwers
T E Strauss*
C J Thornton*
R L M Wohanka

* denotes Executive Director

Company Secretary

C M Herd

Independent Auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Cornwall Court
19 Cornwall Street
Birmingham
B3 2DT

Registered Office

25 Gresham Street,
London,
EC2V 7HN

Company Registration Number

204373

STRATEGIC REPORT

The Directors present their strategic report on the Company for the year ended 31 December 2013

The Company forms part of the General Insurance business unit within the Insurance Division of Lloyds Banking Group ("Group" or "LBG"), focusing on protecting today for our customers. In the aftermath of the October and December storms, our Home Claims teams have worked hard to offer seamless service at a distressing time for many of our customers.

Our strategy to help our customers "Protect Today" is geared to meeting the needs of our society by

- Being customer centric,
- Having a clear market focus, and
- Leveraging our unique Group advantage

As part of the LBG Insurance Division strategy the Company underwrites General Insurance, including household and domestic all risks insurance, creditor insurance, pet insurance, accident and health insurance marketed primarily under the Lloyds Bank (formerly Lloyds TSB), Bank of Scotland and Halifax brands and sold predominantly through LBG and corporate partnerships. The Company is focussed on investing in the growth of its customer base and ensuring policyholder obligations are met at the same time ensuring the company is managed to maximise capital efficiency and returns for its shareholder and the LBG Insurance Division. To support this, the Company is focussed on the following key performance indicators:

- Result and dividends for the year,
- Net insurance premiums,
- Claims and loss adjustment expenses,
- Combined ratio,
- Regulatory capital in excess of internal buffers, and
- Liquidity position

Result and dividends for the year

The result of the Company for the year ended 31 December 2013 is a profit before tax of £84m (2012 £120m). This reflects the run off of the creditor book following LBG's decision to cease selling Payment Protection Insurance in 2010, a reduction in home Gross Written Premiums (growth in Retail GWP has been offset by a reduction in Direct GWP) and the impact of the revised terms of trade with the Retail Bank that came into force on 1st January 2013. Claims and loss adjustment expenses were in line with prior year.

Interim dividends of £99m were paid during the year in respect of 2013 (2012 £32m).

Key performance indicators*Net insurance premiums*

Net insurance premiums reduced to £526m in 2013 (2012 £551m) reflecting the run off of the creditor book and a reduction in home Gross Written Premiums in the Direct business.

Claims and loss adjustment expenses

Claims and loss adjustment expenses are in line with prior year (2013 £193m, 2012 £193m) reflecting the run off of the creditor book offset by the cost of the December 2013 flood event on the home book.

Combined ratio

The Company's combined ratio has increased to 86% (2012 81%) reflecting the reduction in the Company's net premium income and the impact of revised terms of trade on the home book which came into force on 1 January 2013.

Capital Resources

The Directors believe that the Company currently has adequate capital resources and will continue to do so in the foreseeable future. On a Pillar 1 basis the Company's regulatory surplus in excess of capital requirements is £141m (2012, £159m). The reduction in the Company's capital surplus of £18m is primarily due to profit after tax for the year of £86m being more than offset by dividends paid of £99m.

STRATEGIC REPORT (continued)*Solvency II*

Our business model as a Single Integrated Insurance Business positions us to maximise the capital benefits from risk diversification available under the Prudential Regulation Authority ("PRA") Individual Capital Assessment Plus (ICA plus) regime and ultimately Solvency II. When Solvency II is fully implemented, it is expected that the Insurance Division of LBG will be able to recognise the capital diversification benefits which will flow from the management of capital and risk within this overall structure. The implementation date for Solvency II within the European Union has been deferred until 1 January 2016, although some transitional measures to demonstrate preparedness will apply during 2015.

The Company's preparations on Solvency II are continuing, although the Single Integrated Insurance Business structure will enable the business to operate effectively within the transitional arrangements that have been proposed. The Company has already embedded Solvency II into its way of working and takes this into account when considering capital requirements. The Company has developed a Risk Management Framework, with the Own Risk and Solvency Assessment ("ORSA") a central feature to the Company framework.

Liquidity

The Company regularly monitors its liquidity position, which includes stressed outflows that are based on the most severe of several scenarios. Company-specific stress scenarios, PRA market-wide scenarios, and PRA market-wide scenarios with Insurance-specific overlays.

Other Sources

The Company also forms part of LBG's Insurance Division. The development, performance and position of the Insurance Division are presented within LBG's annual report, which does not form part of this report.

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. In addition, the Directors are of the opinion that the information contained in the Company's PRA returns on capital resources and requirements and regular actuarial reports, in conjunction with the information presented in the financial statements as a whole, provide the management information necessary for the Directors to understand the development, performance and position of the business of the Company. Along with fellow direct and indirect subsidiaries of the ultimate insurance parent undertaking, the Company is included in the calculation of the Scottish Widows Group capital surplus. This is calculated in accordance with the Insurance Groups Directive, and is reported in the LBG annual report.

Review of the business

In addition to the progress made against the strategic initiatives summarised earlier there are other areas that are worthy of note and these are described below.

Investment strategy

The Company continues to practice efficient balance sheet management with a focus on investment and liquidity management opportunities, leveraging wider LBG's skills and capabilities. During 2013 excess liquidity was invested in less liquid asset backed securities purchased from, or issued by, parties within LBG. 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 25.

Outlook

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 financial statements.

STRATEGIC REPORT (continued)**Principal risks and uncertainties**

The management of the business and the execution of the Company's strategy is subject to a number of risks. The financial risk management objectives and policies of the Company and the exposure to market, insurance, credit, financial soundness, conduct, operational and political risk and uncertainties are set out in note 25.

In addition, the Company is also exposed to financial and prudential regulatory reporting risk, in particular the risk of reputational damage, financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over financial reporting or over prudential regulatory reporting and financial reporting fraud. The financial and risk management objectives and policies of the Company in respect of financial and prudential regulatory reporting risk are also set out in note 25.

On behalf of the Board of Directors

A M Parsons
Director
20 March 2014



DIRECTORS' REPORT

Lloyds Bank 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 activities

As part of a group rebrand resulting from the creation of the TSB bank, Lloyds TSB General Insurance Limited changed its name to Lloyds Bank General Insurance Limited on the 23rd September 2013.

The principal activity of the Company is to underwrite General Insurance, including household and domestic all risks insurance, creditor insurance, pet insurance, accident and health insurance marketed primarily under the Lloyds Bank (formerly Lloyds TSB), Bank of Scotland and Halifax brands and sold predominantly through the Lloyds Banking Group ("Group" or "LBG") and corporate partnerships. All contracts of insurance are written in the United Kingdom.

Results

The result of the Company for the year ended 31 December 2013 is a profit before tax of £84m (2012: £120m).

Interim dividends of £99m were paid during the year in respect of 2013 (2012: £32m). The Directors do not recommend any further dividend in respect of 2013.

Post balance sheet event

In February 2014 a collateralised loan between the Company and Scottish Widows plc was agreed, this will be effective on the 14th March 2014. More detail is given in note 30.

Directors

The names of the present Directors of the Company are shown on page 3.

The following changes in Directors have taken place during the year:

A M Peck	(Resigned 31 May 2013)
D J Walkden	(Resigned 1 June 2013)
R L M Wohanka	(Appointed 1 June 2013)
C J Thornton	(Appointed 1 June 2013)
V Maru	(Appointed 18 June 2013)

Lloyds Banking Group plc has granted to the Directors of the Company a deed of indemnity through deed poll which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deed was in force during the whole of the financial year and at the date of approval of the financial statements. Directors no longer in office but who served on the Board of the Company at any time in the financial year had the benefit of this contract of indemnity during that period of service. The indemnity remains in force for the duration of a Director's period of office. The deed indemnifies the Directors to the maximum extent permitted by law. The Deed for existing Directors is available for inspection at the registered office of Lloyds Banking Group plc. In addition, the Group has in place appropriate Directors and Officers Liability Insurance cover which was in place throughout the financial year.

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.

DIRECTORS' REPORT (continued)**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.

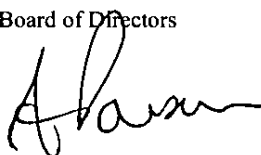
The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies 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.

Each of the Directors whose names are listed on page 3 confirms that, to the best of their knowledge

the Company financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Company, and the Strategic Report on pages 4 to 6 and the Directors' Report on pages 7 and 8 include a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that it faces.

On behalf of the Board of Directors

A M Parsons
Director
20 March 2014



INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LLOYDS BANK GENERAL INSURANCE LIMITED**Report on the financial statements****Our opinion**

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2013 and of its profit and cash flows for the year then ended,
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006

This opinion is to be read in the context of what we say below

What we have audited

The financial statements for the year ended 31 December 2013, which are prepared by Lloyds Bank General Insurance Limited, 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 comprises applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union

In applying the financial reporting framework, the Directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)). 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 Annual Report and Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

Opinion on 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

Other matters on which we are required to report by exception**Adequacy of accounting records and information and explanations received**

Under the Companies Act 2006 we are required to report to you if, in our opinion

- we have not received all the information and explanations we require for our audit, or
- adequate accounting records have not been, 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

We have no exceptions to report arising from this responsibility

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LLOYDS BANK GENERAL INSURANCE LIMITED
(continued)****Directors' remuneration**

Under the Companies Act 2006 we are required to report if, in our opinion, certain disclosures of Directors' remuneration specified by law have not been made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit**Our responsibilities and those of the Directors**

As explained more fully in the Directors' Responsibilities Statement set out on page 8, 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 ISAs (UK & 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.



David Roper (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Birmingham
21 March 2014

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2013

	Notes	2013 £000	2012 £000
Revenue			
Gross earned premiums	3	540,904	572,149
Premiums ceded to reinsurers	3	(14,900)	(21,101)
Premiums net of reinsurance		526,004	551,048
Net investment income	4	4,247	5,355
Net gains on assets at fair value through profit or loss	5	4,896	9,064
Total revenue		535,147	565,467
Net insurance claims			
Claims and loss adjustment costs	6	(192,862)	(192,851)
Claims costs recoverable from reinsurers	6	1	1
Claims and loss adjustment costs		(192,861)	(192,850)
Expenses			
Expenses for the acquisition of insurance contracts	7	(213,670)	(218,461)
Expenses for administration	7	(44,256)	(34,066)
		(257,926)	(252,527)
Total expenses		(450,787)	(445,377)
Profit before tax		84,360	120,090
Taxation credit / (charge)	9	1,173	(26,991)
Profit for the year		85,533	93,099

There are no items of comprehensive income which have not already been presented in arriving at the profit for the year. Accordingly, the profit for the year is the same as total comprehensive income for the year.

The notes on pages 15 to 48 form an integral part of these financial statements.

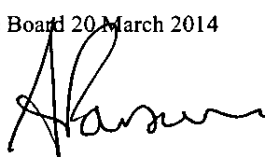
BALANCE SHEET AS AT 31 DECEMBER 2013

	Notes	2013 £000	2012 £000
ASSETS			
Intangible insurance assets	10	56,534	61,411
Reinsurance assets	11	6,299	10,352
Prepayments	12	1	116
Financial assets			
Loans and receivables	13	237,845	243,316
Investments at fair value through profit or loss	14	487,584	467,990
Cash and cash equivalents	15	67,591	128,921
Total assets		855,854	912,106
EQUITY AND LIABILITIES			
Capital and reserves attributable to the Company's equity shareholder			
Share capital	16	61,700	61,700
Retained earnings		245,621	259,088
Total equity		307,321	320,788
LIABILITIES			
Insurance contracts	17	406,128	425,895
Deferred tax liabilities	18	18,245	20,514
Current tax payables	18	18,796	73,133
Provisions for other liabilities and charges	19	6,349	6,604
Accruals	20	481	443
Financial liabilities			
Other financial liabilities	21	98,534	64,729
Total liabilities		548,533	591,318
Total liabilities and equity		855,854	912,106

The notes on pages 15 to 48 form an integral part of these financial statements

Approved by the Board 20 March 2014

A M Parsons
Director



STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2013

	Notes	2013 £000	2012 £000
Cash flows from operating activities			
Profit before tax		84,360	120,090
Adjusted for			
Investment income and net fair value gains on assets held at fair value through profit or loss		(9,143)	(14,419)
Net decrease in operating assets and liabilities	22	28,338	69,975
Taxation paid		(55,434)	-
Net cash flows from operating activities		48,121	175,646
Cash flows from investing activities			
Net (addition) of investments at fair value through profit or loss		(14,646)	(73,024)
Interest received		507	3,048
Dividend and other income received		3,718	2,205
Net cash flows from investing activities		(10,421)	(67,771)
Cash flows from financing activities			
Dividends paid	23	(99,000)	(32,000)
Net cash flows from financing activities		(99,000)	(32,000)
Net (decrease)/increase in cash and cash equivalents		(61,300)	75,875
Cash and cash equivalents at the beginning of the year	15	128,891	53,016
Net cash and cash equivalents at the end of the year	15	67,591	128,891

The notes on pages 15 to 48 form an integral part of these financial statements

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2013

	Notes	Issued share capital £000	Retained earnings £000	Total equity £000
Balance at 1 January 2012		61,700	197,989	259,689
Profit for the year and total comprehensive income for the year		-	93,099	93,099
Dividends paid	23	-	(32,000)	(32,000)
Balance at 31 December 2012		61,700	259,088	320,788
Profit for the year and total comprehensive income for the year			85,533	85,533
Dividends paid	23		(99,000)	(99,000)
Balance at 31 December 2013		61,700	245,621	307,321

Not all of the above amounts can be distributed to the equity holder since the Company is required to meet regulatory capital requirements. Further details are given in note 25.

The notes on pages 15 to 48 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

1. Accounting policies

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

(a) Basis of presentation

The financial statements have been prepared

- (1) in accordance with the International Accounting Standards ("IASs") and International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board and the Standards and Interpretations ("SICs") and International Financial Reporting Interpretations ("IFRICs") issued by its International Financial Reporting Interpretations Committee, as endorsed by the EU,
- (2) in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRSs,
- (3) under the historical cost convention, as modified by the revaluation of certain financial assets and financial liabilities at fair value through profit or loss, as set out in the relevant accounting policies

The Directors are satisfied that the Company has adequate resources to continue in business for the foreseeable future. Accordingly, the financial statements of the Company have been prepared on a going concern basis.

In accordance with IAS 1 "Presentation of Financial Statements", assets and liabilities in the balance sheet are presented in accordance with management's estimated order of liquidity. Analysis of the assets and liabilities of the Company into amounts expected to be received or settled within 12 months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in the notes.

Under section 400 of the Companies Act (CA 2006 s400) the Company is not required to undertake the consolidation of subsidiaries. The Company forms part of LBG, which prepares a group set of consolidation financial statements under IFRS.

Standards and interpretations effective in 2013

A number of standards, amendments to and interpretations of published standards which have the potential to impact on the Company's financial statements have been issued and are mandatory for accounting periods beginning on or after 1 January 2013. Their relevance to the Company's financial statements is assessed at note 28.

Details of standards and interpretations in issue but which have not been adopted early are set out at note 28.

(b) Financial assets and financial liabilities

Management determines the classification of its financial assets and financial liabilities at initial recognition. Management's policies for the recognition of specific financial assets and financial liabilities, as identified on the balance sheet, are set out under the relevant accounting policies.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Company has transferred substantially all of the risks and rewards of ownership. Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

All financial assets and financial liabilities are designated at fair value through profit or loss, with the exception of certain loans and receivables and other financial liabilities which are stated at amortised cost (as described in policies (h) and (q) respectively). The classification depends on the purpose for which financial assets and financial liabilities were acquired.

Financial assets designated as at fair value through profit or loss at inception are managed and their performance evaluated on a fair value basis. Information on these financial assets is provided internally on a fair value basis to the Company's key management. The Company's investment strategy is to invest in equity and debt securities and cash, and to evaluate the Company's investments with reference to their fair values.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

(c) Fair value methodology

All assets and liabilities carried at fair value, or for which a fair value measurement is disclosed, are categorised into a “fair value hierarchy” as follows

(i) Level 1

Valued using quoted prices (unadjusted) in active markets for identical assets and liabilities to those being valued. An active market is one in which similar arm’s length transactions in the instrument occur with both sufficient frequency and volume to provide pricing information on an ongoing basis. Examples include listed equities, listed debt securities, Open Ended Investment Companies (“OEICs”) and unit trusts traded in active markets and exchange traded derivatives such as futures

(ii) Level 2

Valued using inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices). If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following

- Quoted prices for similar (but not identical) instruments in active markets,
- Quoted prices for identical or similar instruments in markets that are not active, where prices are not current, or price quotations vary substantially either over time or among market makers,
- Inputs other than quoted prices that are observable for the instrument (for example, interest rates and yield curves observable at commonly quoted intervals and default rates),
- Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means

Examples of these are securities measured using discounted cash flow models based on listed debt or equity securities in a market that is inactive

(iii) Level 3

Valued using inputs for the asset or liability that include significant unobservable inputs (inputs not based on observable market data). Unobservable inputs may have been used to measure fair value where observable inputs are not available. This approach allows for situations in which there is little, if any, market activity for the asset or liability at the measurement date (or market information for the inputs to any valuation models). Unobservable inputs reflect the assumptions the Company considers that market participants would use in pricing the asset or liability, for example private equity investments held by the Company

Where estimates are used, these are based on a combination of independent third-party evidence and internally developed models, calibrated to market observable data where possible

Further analysis of the Company’s instruments held at fair value is set out at note 25

The Company’s management, through a fair value pricing committee, review information on the fair value of the Company’s financial assets and financial liabilities and the sensitivities to these values on a regular basis

No assets are classified as held-to-maturity or available-for-sale. No liabilities are classified as held for trading

Transaction costs incidental to the acquisition of a financial asset are expensed through the statement of comprehensive income, within net gains and losses on assets and liabilities at fair value through profit or loss

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously

Transfers between different levels of the fair value hierarchy are deemed to have occurred at the next reporting date after the change in circumstances that caused the transfer

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

1. Accounting policies (continued)**(d) Revenue recognition****Premium income**

Premiums received in respect of all general insurance contracts 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 "Other financial liabilities".

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.

Investment income

Interest income for all interest-bearing financial instruments is recognised in the statement of comprehensive income as it accrues, within investment income.

Dividends receivable in respect of listed shares and collective investment vehicles are recognised on the date that these are quoted ex-dividend, other dividend income is recognised when received. All dividends received are recognised through the statement of comprehensive income, within investment income.

Net gains and losses on assets at fair value through profit or loss

Net gains and losses on 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 year in which they arise.

(e) Expense recognition**Claims and loss adjustment expenses**

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 where the contract holders are liable. 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.

Operating expenses

Commissions and other acquisition costs are recognised through the statement of comprehensive income, within expenses for the acquisition of insurance contracts. Commission and other acquisition costs that vary with and are directly related to securing new contracts and renewing existing contracts are deferred as set out in policy (f).

Other operating expenses are recognised in the statement of comprehensive income as incurred, within expenses for administration.

(f) Intangible insurance assets**Deferred acquisition costs ("DAC")**

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

1. Accounting policies (continued)

(g) 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 dependent 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 year. 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 policy (k).

(h) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that are not designated as fair value through profit or loss at initial recognition.

Loans and receivables are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost, subject to impairment. In practice the carrying value of these balances equates to the fair value due to the short-term nature of the amounts included within loans and receivables.

A charge for impairment in respect of loans and receivables would be made in the statement of comprehensive income when there is objective evidence that the Company will not be able to collect all amounts due according to their original terms. The impairment charge would be recognised through of the statement of comprehensive income within operating expenses. Receivables arising from insurance contracts are also classified in this category and are reviewed for impairment as part of the impairment review of loans and receivables.

(i) Investments at fair value through profit or loss

Investments at fair value through profit or loss comprise debt and equity securities.

Classification

A financial asset is classified in this category at inception if acquired principally for the purpose of selling in the short-term, if it forms part of a portfolio of financial assets in which there is evidence of short-term profit-taking, or if designated as such.

Recognition

Purchases and sales of financial assets are recognised on the trade date, i.e. the date the Company commits to purchase the asset from, or deliver the asset to, the counterparty. Investments are initially recognised at cost, being the fair value of the consideration given, and are subsequently remeasured at fair value.

Measurement

The fair values of investments are based on current bid prices. If the market for a financial asset is not active, and also for unlisted securities, the Company establishes fair value by using valuation techniques. These include the use of similar arm's length transactions and reference to other instruments that are substantially the same, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

1 Accounting policies (continued)**(i) Investments at fair value through profit or loss (continued)**

For quoted debt security investments, bid prices at the final pricing point on the reporting date are obtained from index providers who obtain prices from a number of leading brokers, investment banks and market makers. Where no independent price is available, a valuation technique is used to determine fair value. The technique uses a spread over a comparable term gilt as the best estimate of fair value. Spreads are calculated by reference to the wider market movement in credit spreads, the way in which the security is structured, other assets issued by the issuer or other assets with similar characteristics.

For corporate bonds, the Company's management perform a comparison of information received from the index provider used against other available price sources on a monthly basis to ensure that prices can be supported by market data.

The Company holds investments in structured entities arising from investments in unlisted collective investment schemes. The fair value of holdings in unlisted collective investment schemes is determined by using the mark to market values of the individual underlying holdings of the schemes.

In addition to the measurement policies, investment asset prices are reviewed weekly to identify those assets where the price has not moved for at least six days. This review provides an initial indication that the market for each identified asset may be inactive. These assets are then reviewed by management who may identify an alternative price source for assets which in their view are still actively traded. On conclusion that a particular asset is illiquid, management will identify an alternative valuation technique by deciding whether an appropriate price can be obtained from a recognised independent broker. Where this is the case, the broker will be approved as a price source for the asset. A price will then be obtained from the broker on a monthly basis. A review of all illiquid assets and prices obtained or calculated is conducted by the Fair Value Pricing Committee on a monthly basis.

In order to ensure that a fair value is recognised for unquoted or illiquid debt securities, the primary price source is an external broker valuation. If available, a further external broker valuation is sought as a secondary valuation source in order to validate the primary source. A formal review is then carried out which challenges the external valuation and includes consideration of the impact of any relevant movements in underlying variables such as:

- underlying movements in the relevant markets, for example credit spreads,
- how current transactions are being priced in the market,
- how the security is structured, and
- any supporting quantitative analysis as appropriate, for example with reference to Bloomberg or internal models.

(j) 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.

(k) Impairment**Financial assets**

The carrying value of all financial assets held at amortised cost is reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. The identification of impairment and the determination of recoverable amounts is an inherently uncertain process involving various assumptions and factors, including the financial condition of the counterparty, expected future cash flows, observable fair prices and expected net selling prices. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

1. Accounting policies (continued)

(k) Impairment (continued)

Non-financial assets

Assets that have an indefinite useful life are not subject to depreciation or 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 estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

If there is objective evidence that an impairment loss has occurred, the amount of the loss is charged to the relevant line in the statement of comprehensive income in the year in which it occurs. Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

Impairment process

Objective evidence that an asset or group of 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,
- (iii) the disappearance of an active market for that asset because of financial difficulties, or
- (iv) observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of assets since the initial recognition of those assets, even where the decrease cannot yet be identified with the individual assets of the Company, including
 - adverse changes in the payment status of issuers or debtors, or
 - national or local economic conditions that correlate with defaults on the assets in the Company

The Company first assesses whether objective evidence of impairment exists individually for assets that are individually significant. If the Company determines that no objective evidence of impairment exists for an individually assessed asset, whether significant or not, it includes the asset in a group of assets with similar credit risk characteristics and collectively assesses them for impairment. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the issuer's ability to pay all amounts due under the contractual terms of the debt instrument being evaluated. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

(l) Taxes

Tax on the profit or loss for the year is recognised in the statement of comprehensive income within taxation and comprises current and deferred tax.

Current tax

Current tax is the expected tax payable on the taxable income for the year, using tax rates and legislation enacted or substantively enacted at the reporting date, together with adjustments to estimates made in prior years.

Deferred income tax

Deferred income 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 for financial reporting purposes at the reporting date. However, if the deferred income tax arises from the initial recognition of an asset or liability in a transaction other than a business combination that, at the time of the transaction, affects neither accounting nor taxable profit or loss, it is not accounted for. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates and legislation enacted or substantively enacted at the reporting date.

Deferred income tax assets are only recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences, carry-forward of unused tax assets and unused tax losses can be utilised.

The carrying amount of deferred income tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the deferred income tax asset to be utilised. Deferred tax assets and liabilities held are undiscounted.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

1 Accounting policies (continued)**(m) Share capital**

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

Dividend distribution

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

(n) Insurance contracts

The Company issues insurance contracts, which transfer significant insurance risk. The Company defines as significant insurance risk 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 not to occur. Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly over time.

Recognition and measurement

All 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 these contracts, 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.

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.

(o) Provisions for other liabilities and charges

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, when it is probable that the obligation will result in an outflow of resources to settle the obligation and when a reliable estimate of the amount of the obligation can be made. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability.

The Company recognises a provision for onerous contracts when the expected benefits to be derived from contracts are less than the unavoidable costs of meeting the obligations under the contracts.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

1. Accounting policies (continued)**(o) Provisions for other liabilities and charges (continued)**

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 the likelihood of possible obligations arising is remote.

(p) Liability adequacy test

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

(q) Other financial liabilities

Other financial liabilities are initially recognised at fair value less directly attributable transaction costs and subsequently measured at amortised cost. In practice, the carrying values of these balances equates to the fair value due to the short-term nature of the amounts included within other financial liabilities.

2 Critical accounting estimates and judgements in applying accounting policies

The Company's management makes estimates and judgements that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

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.

Unemployment claims during the year have continued to fall from their peak in 2009, though still remain marginally 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 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 25.

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 total claims would result in the recognition of an additional cost of £13 800m net of reinsurance (2012 £13 417m). Similarly, an increase of 10% in the number of all claims would result in the recognition of an additional cost of £12 522m net of reinsurance (2012 £14 711m). A 5% increase in the inflation rate of claims would result in the recognition of an additional cost of £6 261m net of reinsurance (2012 £5 938m).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

3 Premiums net of reinsurance

	2013 £000	2012 £000
Short-term insurance contracts		
- premiums receivable (note 17)	526,843	562,097
- change in unearned premium reserve	14,061	10,052
Total gross earned premiums (note 17)	540,904	572,149
Short-term reinsurance contracts		
- premiums payable	(10,978)	(18,383)
- change in unearned premium reserve	(3,922)	(2,718)
Total premiums ceded to reinsurers	(14,900)	(21,101)
Total premiums net of reinsurance	526,004	551,048

4. Net investment income

	2013 £000	2012 £000
Net income on investments designated at fair value through profit or loss	3,770	4,623
Other interest income	477	732
Total	4,247	5,355

Interest income of £2 299m (2012 £1 037m) and dividend income of £1 487m (2012 £1 280m) on assets held at fair value through profit or loss have been reclassified to net investment income from net gains on assets at fair value through profit or loss. This is to align with other Group entities and provide a clearer presentation. 2012 values have been restated.

5. Net gains on assets at fair value through profit or loss

	2013 £000	2012 £000
Net gains on assets at fair value through profit or loss	4,896	9,064
Total	4,896	9,064

Interest income of £2 299m (2012 £1 037m) and dividend income of £1 487m (2012 £1 280m) on assets held at fair value through profit or loss have been reclassified to net investment income from net gains on assets at fair value through profit or loss. This is to align with other Group entities and provide a clearer presentation. 2012 values have been restated.

6. Claims and loss adjustment expenses

	£000	2013 £000	£000	£000	2012 £000	£000
	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>
Current year claims and loss adjustment costs (note 17)	214,975	-	214,975	225,922	-	225,922
Movement in costs of prior year claims and loss adjustment costs (note 17)	(16,023)	(1)	(16,024)	(41,872)	(1)	(41,873)
Movement in the expected cost of claims for unexpired risks (note 17)	(6,090)	-	(6,090)	8,801	-	8,801
Total claims and loss adjustment costs	192,862	(1)	192,861	192,851	(1)	192,850

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

7 Operating expenses

	2013 £000	2012 £000
Fees and commissions payable	176,750	178,717
Acquisition expenses	32,044	30,541
Change in gross deferred acquisition costs	4,876	9,203
Expenses for the acquisition of insurance contracts	213,670	218,461
Expenses for administration	44,256	34,066
Total	257,926	252,527

The administration of the Company is undertaken by another group company. A recharge is levied from this undertaking to the Company in respect of those costs incurred on behalf of the Company, although there are some operating expenses which are incurred directly by the company. In 2013 operating expenses recharged to the Company were £79 980m (2012 £84 283m). In 2013 claims handling expenses of £37 730m (2012 £34 800m) were allocated to insurance claims costs.

The operating expenses disclosure has been aligned to disclose costs in a consistent manner with other group companies. This represents a change to 2012, when operating expenses were analysed by the company.

The Company had no direct employees during the year (2012 nil). Employee costs, including pension costs and share-based payment costs, are included in the recharge noted above.

8 Auditors' remuneration

	2013 £000	2012 £000
Audit fees		
Fees payable to the Company's auditor for the audit of the Company's annual financial statements	239	187
Fees payable to the Company's auditor and its associates for other services		
Non-audit services pursuant to regulation	28	28
Total	267	215

Audit fees for 2013 and 2012 were borne by another company within the group and recharged to the Company.

9. Taxation Charge

(a) Current year tax (credit) / charge

	2013 £000	2012 £000
Current tax:		
UK corporation tax	18,796	27,915
Adjustments in respect of prior years	(17,699)	(2)
Total current tax	1,097	27,913
Deferred tax:		
Deferred tax credit (note 18)	(2,270)	(922)
Total deferred tax	(2,270)	(922)
Total income tax (credit) / charge for the year	(1,173)	26,991

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

9 Taxation Charge (continued)

(b) Reconciliation of tax charge

	2013 £000	2012 £000
Profit before tax	84,360	120,090
Tax charge at effective UK corporation tax rate of 23.25% (2012: 24.5%)	19,614	29,423
Effects of		
Non-taxable income	(346)	(313)
Reduction in deferred tax rate to 20% (2012: 23%)	(2,742)	(1,767)
Adjustments in respect of prior years	(17,699)	-
Additional tax deduction on loans acquired under group continuity rules	-	(352)
Total	(1,173)	26,991

The charge for income taxation on the profit for the year is based on an effective United Kingdom corporation taxation rate of 23.25% (2012: 24.5%) as the standard corporation taxation rate changed from 24% to 23% effective 1 April 2013.

The effective tax rate for the year is -1.4% (2012: 22.5%).

Adjustments in respect of prior years includes £17.699m utilisation of tax losses from a fellow group subsidiary for nil payment.

The Finance Act 2012, which was substantively enacted on 3 July 2012, included legislation to reduce the main rate of corporation tax from 24 per cent to 23 per cent with effect from 1 April 2013. In addition, the Finance Act 2013, which was substantively enacted on 2 July 2013, included legislation to reduce the main rate of corporation tax to 21 per cent with effect from 1 April 2014 and 20 per cent with effect from 1 April 2015. The change in the main rate of corporation tax from 23 per cent to 20 per cent has resulted in a reduction in the Company's net deferred tax liability at 31 December 2013 of £2.742m.

10 Intangible insurance assets

Deferred acquisition costs	2013 £000	2012 £000
At 1 January	61,411	70,614
Additions	208,793	209,258
Amortisation through statement of comprehensive income	(213,670)	(218,461)
At 31 December	56,534	61,411

Of the above total £0.786m (2012: £0.173m) is expected to be recovered more than one year after the reporting date.

11 Reinsurance assets

	2013 £000	2012 £000
Reinsurers' unearned premium (note 17)	5,815	9,737
Reinsurers' share of claims reserves (note 17)	484	615
Reinsurance assets	6,299	10,352

Of the above £0.135m (2012: £0.172m) is expected to be recovered more than one year from the reporting date.

All of the above amounts relate to household and domestic all risks contracts of insurance. The Reinsurers' share of claims reserves relates to creditor insurance.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

12 Prepayments

	2013 £000	2012 £000
Amounts relating to trading balances	1	116
Total	1	116

The above total is all expected to be recovered within one year

In 2013 prepayments of £0 001m (2012 £0 116m) have been reclassified as a separate line item on the balance sheet to align with other group entities for the purpose of clearer presentation. Prepayments were previously reported within loans and receivables. See note 13.

13. Loans and receivables

	2013 £000	2012 £000
Receivables arising from insurance and reinsurance contracts		
- due from contract holders	222,833	228,371
- due from related parties (note 27)	15,012	14,945
Total loans and receivables	237,845	243,316

All loans and receivables are expected to be recovered less than one year after the reporting date.

As at 31 December 2013 overdue loans and receivables arising from insurance contracts of £1 429m were provided for in full (2012 £0 705m).

In 2013 prepayments of £0 001m (2012 £0 116m) have been reclassified as a separate line item on the balance sheet to align with other group entities for the purpose of clearer presentation. Prepayments were previously reported within loans and receivables. See note 12.

14. Investments at fair value through profit or loss

	2013 £000	2012 £000
Collective Investment Schemes – unlisted	326,683	289,529
Debt securities – unlisted	160,901	178,461
Total financial investments at fair value through profit or loss	487,584	467,990

Of the above total £160 901m (2012 £178 461m) is expected to be recovered more than one year after the reporting date.

Interests in unconsolidated structured entities

Included within investments at fair value through profit or loss and cash and cash equivalents are investments in unconsolidated structured entities of £392 543m arising from investments in collective investment schemes.

The collective investment schemes are primarily financed by investments from investors in the schemes. The investments are carried at fair value and the Company's maximum exposure to loss is equal to the carrying value of the investment. However, investments in collective investment schemes are primarily held to match insurance liabilities and the risk from a change in the value of the Company's investment is not considered to be significant due to the short-term nature of the investments and insurance liabilities.

At 31 December 2013, the total net assets of unconsolidated collective investment schemes in which the Company held a beneficial interest was £17,931 807m. During the year the Company has not provided any non-contractual financial or other support to these unconsolidated collective investment schemes.

LBG's asset management businesses sponsors a range of collective investment schemes where it acts as the decision maker over the investment activities and markets the funds under one of LBG's brands. The Company does not earn any fees from the management of the investments of these funds. The carrying value of assets transferred to these funds during the year was £nil.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

15 Cash and cash equivalents

	2013 £000	2012 £000
Cash at bank and in hand	1,731	69,321
Global Liquidity Fund	65,860	59,570
Total cash and cash equivalents for cash flow purposes	67,591	128,891
Accrued interest	-	30
Total cash and cash equivalents	67,591	128,921

The Global Liquidity Fund is an unlisted collective investment scheme reported within cash and cash equivalents due to the short term, highly liquid nature of the underlying investments in the scheme

16 Share capital

	2013 £000	2012 £000
Allotted, called up and fully paid ordinary share capital		
At 1 January and 31 December		
Issued and fully paid – 61 7m shares of £1 each	61,700	61,700
Total	61,700	61,700

The total authorised number of ordinary shares is 65 661 million (2012 65 661 million) 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

17. Insurance contracts

	£000	2013 £000	£000	£000	2012 £000	£000
	<i>Gross</i>	<i>Recoverable from reinsurers</i>	<i>Net</i>	<i>Gross</i>	<i>Recoverable from reinsurers</i>	<i>Net</i>
Short-term insurance contracts:						
Claims reported & loss adjustment costs	133,001	(484)	132,517	128,392	(615)	127,777
Claims incurred but not reported	15,115	-	15,115	19,340	-	19,340
Unexpired risk reserve	5,111	-	5,111	11,201	-	11,201
Unearned premiums	252,901	(5,815)	247,086	266,962	(9,737)	257,225
Total insurance liabilities	406,128	(6,299)	399,829	425,895	10,352	415,543

Of the above total £34 670m (2012 £31 720m) is expected to be settled more than one year after the reporting date

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 2013 and 2012 are not material

The unexpired risk reserve includes £3 660m (2012 £8 759m) in respect of the pet insurance business

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

17 Insurance contracts (continued)

Movements in insurance liabilities and reinsurance assets

(a) Claims and loss adjustment expenses

	£000	2013 £000	£000	£000	2012 £000	£000
	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>
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 beginning of year	147,732	(615)	147,117	173,170	(1,366)	171,804
Cash paid for claims settled in the year	(198,568)	131	(198,437)	(209,488)	752	(208,736)
Increase in liabilities						
- arising from current year claims (note 6)	214,975	-	214,975	225,922	-	225,922
- arising from prior year claims (note 6)	(16,023)	-	(16,023)	(41,872)	(1)	(41,873)
Total at end of year	148,116	(484)	147,632	147,732	(615)	147,117
Notified claims	133,001	(484)	132,517	128,392	(615)	127,777
Incurred but not reported	15,115		15,115	19,340	-	19,340
Total at end of year	148,116	(484)	147,632	147,732	(615)	147,117

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 25

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

	£000	2013 £000	£000	£000	2012 £000	£000
	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>	<i>Gross</i>	<i>Reinsurance</i>	<i>Net</i>
Unearned premiums						
At 1 January	266,962	(9,737)	257,225	277,014	(12,455)	264,559
Increase in the year (note 3)	526,843	(10,978)	515,865	562,097	(18,383)	543,714
Release in the year (note 3)	(540,904)	14,900	(526,004)	(572,149)	21,101	(551,048)
At 31 December	252,901	(5,815)	247,086	266,962	(9,737)	257,225
Unexpired risk reserve						
At 1 January	11,201	-	11,201	2,400	-	2,400
Increase in the year (note 6)	-	-	-	9,174	-	9,174
Release in the year (note 6)	(6,090)	-	(6,090)	(373)	-	(373)
At 31 December	5,111	-	5,111	11,201	-	11,201

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 and pet policies for which the Company expects to pay claims in excess of the related unearned premium provision.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

18 Tax liabilities

	2013 £000	2012 £000
Current tax payables	18,796	73,133
Deferred tax liabilities	18,245	20,514
Total tax liabilities	37,041	93,647

Of the deferred tax liabilities in the above table, none is expected to be settled within one year of the reporting date

Recognised deferred tax

Deferred income tax assets and deferred liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. Deferred income tax is calculated in full on temporary differences under the liability method using a tax rate of 20% (2012 23%)

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

	2013 £000	2012 £000
Deferred tax assets comprise		
Accelerated capital allowances	-	2
Total deferred tax assets	-	2
Deferred tax liabilities comprise:		
CER Provision	18,245	20,514
Total deferred tax liabilities	18,245	20,514
Net deferred tax liabilities	18,245	20,514

Deferred income tax is calculated in full on temporary differences under the liability method using a tax rate of 20% (2012 23%)

The tax (credit) in the income statement relating to each of the above items is as follows

	2013 £000	2012 £000
CER Provision	(2,270)	(924)
Total deferred tax (credit)	(2,270)	(924)

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

19. Provision for other liabilities and charges

	Premium rebates £000	FSCS levy £000	2013 Total £000	Premium rebates £000	FSCS levy £000	2012 Total £000
At 1 January	4,952	1,652	6,604	1,752	826	2,578
Utilised during the year	(433)	(1,362)	(1,795)	(7,482)	(729)	(8,211)
Statement of comprehensive income charge						
- additional provisions	3,811	1,362	5,173	4,952	1,652	6,604
- (over)/under provision from prior years	(3,343)	(290)	(3,633)	5,730	(97)	5,633
At 31 December	4,987	1,362	6,349	4,952	1,652	6,604

All of the above provision (2012 £4 804m) is expected to be utilised within one year of the reporting date

(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.

(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 authorised by the Prudential Regulatory Authority (PRA) and/or the Financial Conduct Authority (FCA). The FCA has until 31 March 2014 to finalise its levy in respect of its financial year 2013/14.

It is not anticipated that any further levy will be raised for 2013/14. The contingent liability is estimated to be £10 663m for the 2013 basis year. The FSCS has issued its Plan and Budget for 2014/15 and a provision of £1 362m in respect of this levy is held in these financial statements.

20. Accruals

	2013 £000	2012 £000
Accrued expenses	481	443
Total	481	443

All accruals are current liabilities.

In 2013 accruals of £0 481m (2012 £0 443m) have been reclassified as a separate line item on the balance sheet to align with other group entities for the purpose of clearer presentation. Accruals were previously reported within other financial liabilities. See note 21.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

21. Other financial liabilities

	2013 £000	2012 £000
Due to related parties	74,579	37,508
Insurance payables	11,542	18,632
Other payables	6,204	1,156
Other taxes payable	6,209	7,433
Total	98,534	64,729

All trade and other payables are current liabilities

In 2013 accruals of £0 481m (2012 £0 443m) have been reclassified as a separate line item on the balance sheet to align with other group entities for the purpose of clearer presentation. Accruals were previously reported within other financial liabilities. See note 20

22. Decrease in operating assets and liabilities

	2013 £000	2012 £000
Decrease in operating assets		
Intangible insurance assets	4,877	9,203
Financial assets		
Loans and receivables	5,587	94,567
Net decrease in operating assets	10,464	103,770
Increase / (decrease) in operating liabilities		
Insurance contract liabilities (net)	(15,714)	(23,220)
Provisions for other liabilities and charges	(255)	4,026
Financial liabilities Other financial liabilities	33,843	(14,601)
Net increase / (decrease) in operating liabilities	17,874	(33,795)
Net decrease in operating assets and liabilities	28,338	69,975

23. Dividends paid

	2013 £000	2012 £000
Total dividends paid on equity shares	99,000	32,000

The Board of Directors approved total dividends payable to Lloyds Bank General Insurance Holdings Limited (formerly Lloyds TSB General Insurance Holdings Limited) of £99m (£1 60 per share) during the year in respect of 2013 (2012 £32m (£0 52 per share))

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

24 Short-term insurance contracts – assumptions, change in assumptions and sensitivities

(1) Processes used to determine key assumptions in respect of insurance and investment contracts

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 Calibration Working Group (CWG) and Claims & Reserving Committee (C&RC) Reports.

These reports from the Head of Actuarial and recommendations are formally reviewed by the Claims and Reserving Committee on a regular basis.

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

(2) Key assumptions**(a) 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.

(b) 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

24 Short-term insurance contracts – assumptions, change in assumptions and sensitivities (continued)

Claims incurred but not reported reserve (IBNR)

The IBNR is calculated in the same way as the OCR, though uses total duration

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 £1 451m (2012 £2 442m) in respect of the single premium creditor business 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

(c) 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	2009	2010	2011	2012	2013	Total
	£000	£000	£000	£000	£000	£000
Estimate of ultimate claims costs						
- at end of accident year	161,951	174,685	139,803	174,854	175,471	826,764
- one year later	153,194	168,892	130,133	161,742		-
- two years later	138,663	164,937	125,763	-		-
- three years later	137,344	165,705	-	-		-
- four years later	138,421	-	-	-		-
Current estimate of cumulative claims	138,421	165,705	125,763	161,742	175,471	767,102
Cumulative payments to date	(136,349)	(160,871)	(119,607)	(148,477)	(85,771)	(651,075)
Liability recognised in the balance sheet	2,072	4,834	6,156	13,265	89,700	116,027
Liability in respect of prior years						2,854
Total gross liability included in the balance sheet						118,881

Household and domestic all risks -net						
Accident year	2009	2010	2011	2012	2013	Total
	£000	£000	£000	£000	£000	£000
Estimate of ultimate claims costs						
- at end of accident year	161,951	174,685	139,803	174,854	175,471	826,764
- one year later	153,194	168,892	130,133	161,742	-	-
- two years later	138,663	164,937	125,763	-	-	-
- three years later	137,344	165,705	-	-	-	-
- four years later	138,421	-	-	-	-	-
Current estimate of cumulative claims	138,421	165,705	125,763	161,742	175,471	767,102
Cumulative payments to date	(136,349)	(160,871)	(119,607)	(148,477)	(85,771)	(651,075)
Liability recognised in the balance sheet	2,072	4,834	6,156	13,265	89,700	116,027
Liability in respect of prior years						2,370
Total net liability included in the balance sheet						118,397

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

24 Short-term insurance contracts – assumptions, change in assumptions and sensitivities (continued)

(c) Claims development tables (continued)

As at the year ended 31 December 2013 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 2013. 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 loss catastrophe reinsurance programme is to protect against the adverse effects of large weather related events.

The gross liability of £118 881m and net liability of £118 397m shown in the above tables exclude £5 882m of unallocated claims handling expenses.

Creditor – gross and net Accident year	2009 £000	2010 £000	2011 £000	2012 £000	2013 £000	Total £000
Estimate of ultimate claims costs						
- at end of accident year	99,120	70,832	44,112	18,343	9,270	241,677
- one year later	82,879	45,386	24,500	14,268	-	-
- two years later	75,871	41,773	24,454	-	-	-
- three years later	69,211	41,885	-	-	-	-
- four years later	67,489	-	-	-	-	-
Current estimate of cumulative claims	67,489	41,885	24,454	14,268	9,270	157,366
Cumulative payments to date	(66,069)	(37,321)	(20,892)	(11,512)	(2,923)	(138,717)
Liability recognised in the balance sheet	1,420	4,564	3,562	2,756	6,347	18,649
Liability in respect of prior years						16
Total liability included in the balance sheet						18,665

The Company has not had any reinsurance cover in place for the current and preceding 5 years in respect of creditor insurance business.

The liability of £18 665m shown in the above table excludes £3 751m of unallocated claims handling expenses.

Sensitivity analysis of claims liabilities is included in note 2.

25 Risk management

The principal activity of the Company is the undertaking of general insurance business in the United Kingdom. The Company underwrites a range of general insurance products such as household and domestic all risks insurance, creditor insurance, pet insurance and accident and health insurance. Products are marketed primarily under the Lloyds Bank, Bank of Scotland and Halifax brands and sold predominantly through the LBG network and corporate partnerships. The Company also reinsures business with insurance entities external to the Company.

The Company assesses the relative costs and concentrations of each type of risk through the Individual Capital Assessment (“ICA”) and Solvency II capital assessments and material issues are escalated to the Insurance Risk Committee and the Insurance Executive Committee.

This note summarises these risks and the way in which the Company manages them.

(a) Governance framework

The Company is part of LBG, which has established a risk management function with responsibility for implementing the LBG risk management framework within the Group.

Responsibility for the setting and management of risk appetite and risk policy resides with the Board of each Group company. The Board manages risks in line with LBG and Insurance risk policies. The Board has delegated operational implementation to the Insurance Executive Committee.

The approach to risk management aims to ensure that there is effective independent checking or “oversight” of key decisions through the operation of a “three lines of defence” model. The first line of defence is line management, who have direct accountability for risk decisions. The Risk function provides oversight and challenge and forms the second line of defence.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

25 Risk management (continued)**Governance framework (continued)**

Internal Audit constitutes the third line of defence, whose objective is to provide the required independent assurance to the Audit Committee and the Board that risks within the Company are recognised, monitored and managed within acceptable parameters

An enterprise-wide risk management framework for the identification, assessment, measurement and management of risk is in place. The framework is in line with LBG's risk management principles and covers the full spectrum of risks that the Company is exposed to. Under this framework, risks are categorised according to an approved LBG risk language which has been adopted by the Company. This covers the principal risks faced by the Company, including the exposures to market, insurance, credit, financial soundness and operational risk. The performance of the Company, its continuing ability to write business and the strategic management of the business depend on its ability to manage these risks.

Policy owners, identified from appropriate areas across the business, are responsible for drafting the LBG and Insurance risk policies, for ensuring that they remain up-to-date and for facilitating any changes. These policies are subject to at least an annual review, or earlier if deemed necessary. Limits are prescribed within which those responsible for the day to day management of the Company can take decisions. Line management are required to follow prescribed reporting procedures to the bodies responsible for monitoring compliance with policy and controlling the risks.

(b) Risk appetite

Risk Appetite is the amount and type of risk that the Board is prepared to seek, accept or tolerate and is fully aligned to LBG Strategy. The Board has defined the methodology for the management of Risk Appetite and approved a set of Risk Appetite Statements that cover Financial Risks (Strategic, Solvency and Capital, Earnings and Liquidity), Operational Risks, People and Risk Culture, Conduct Risks and Regulatory Risks. The Risk Appetite Statements set limits for exposures to the key risks faced by the business.

Experience against Risk Appetite is reported monthly to the Insurance Risk Committee, quarterly to the Insurance Risk Oversight Committee, to the LBG Group Risk Committee and to the LBG Board Risk Committee, and bi-annually to the Insurance Board. Copies are also supplied regularly to Insurance's regulators as part of the close and continuous relationship. Reporting focuses on ensuring, and demonstrating to the Insurance Board, and their delegate the Insurance Risk Oversight Committee, that Insurance is run in line with approved Risk Appetite. Any breaches of Risk Appetite require clear plans and timescales for resolution.

(b) Financial risks

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, insurance risk, credit risk and financial soundness risk.

The Company manages these risks in a number of ways, including risk appetite assessment and monitoring of capital resource requirements. 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.

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting policies (note 1) describes how the classes of financial instruments are measured and how income and expenses, including fair value gains and losses, are recognised.

The timing of the unwind of the deferred tax assets and liabilities is dependent on the timing of the unwind of the temporary timing differences, arising between the tax bases of the assets and liabilities and their carrying amounts for financial reporting purposes, to which these balances relate.

The sensitivity analyses given throughout this note are based on a change in an assumption while holding all other assumptions constant unless stated otherwise. In practice, this is unlikely to occur as changes in some of the assumptions may be correlated, for example changes in interest rates and changes in market values. The sensitivity analysis presented also represents, in accordance with the requirements of IFRS 7, management's assessment of a reasonably possible alternative in respect of each sensitivity, rather than worst case scenario positions unless stated otherwise.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

25 Risk management (continued)

(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 prices (equity 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 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 FCA 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 – All classed as level 3, comprising asset backed securities and covered bonds which are not actively traded and are valued using a discounted cash flow model.

An analysis of financial assets at fair value through profit or loss according to their fair value hierarchy (as defined in note 1(c)) is given below:

As at 31 December 2013

	Fair value hierarchy			Total £000
	Level 1 £000	Level 2 £000	Level 3 £000	
Collective Investment Schemes – unlisted	326,683	-	-	326,683
Debt securities – unlisted	-	-	160,901	160,901
Total assets	326,683	-	160,901	487,584

As at 31 December 2012

	Fair value hierarchy			Total £000
	Level 1 £000	Level 2 £000	Level 3 £000	
Collective Investment Schemes – unlisted	289,529	-	-	289,529
Debt securities – unlisted	-	-	178,461	178,461
Total assets	289,529	-	178,461	467,990

The unlisted debt securities classified as Level 3 above 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 of 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 £2.571m or increase it by £2.655m.

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):

	2013 £000	2012 £000
Balance at 1 January	178,461	-
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	2,160	742
Purchases	29,935	179,778
Disposals	(49,656)	(2,059)
Balance at 31 December	160,900	178,461
Total gains for the period included in the statement of comprehensive income for assets held at 31 December	2,006	676

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

25 Risk management (continued)

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 2013 was £20.051m (2012: £16.6m). The VaR has increased due to the impact of purchasing unlisted debt securities during the year.

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. Interest rate risk in respect of the Company's insurance contracts arises when there is a mismatch in duration or yield between liabilities and the assets backing those liabilities.

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.

	2013 £m	2012 £m
Impact on profit after tax and equity at reporting date		
25 basis points increase in interest rates	1.1	0.3
25 basis points decrease in interest rates	(1.1)	(0.3)

(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 PRA 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.

(i) 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).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

25 Risk management (continued)

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 £595.2m is £135.2m across Lloyds Banking Group General Insurance (2012: £676.3m, £92.9m).

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.

(ii) Creditor**(a) Frequency and severity of claims**

Significant perils and risk factors include unemployment, morbidity, 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 still remain marginally 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 slight decrease in the proportion of claimants transitioning to later claim duration periods.

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

25. Risk management (continued)

(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 £1 451m (2012 £2 442m) in respect of the single premium creditor business 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

(3) Credit risk

Credit risk is the risk of reductions in earnings and/or value, through financial or reputational loss, as a result of the failure of the party with whom the Company has contracted to meet its obligations

Investment counterparty default risk arises primarily from holding invested assets to meet liabilities, and reinsurer default credit risk primarily arises from exposure to reinsurers

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 provision for doubtful debt is recognised when payments due from policyholders have not been received for at least a month

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

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 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 table below analyses financial assets subject to credit risk using Moody's or equivalent

Financial assets held at fair value through profit or loss:

As at 31 December 2013

	Total £000	AAA £000	AA/A £000	B £000	Not Rated £000
Assets arising from reinsurance contracts held	6,299	-	6,299	-	-
Loans and receivables	237,845	-	2,071	2,761	233,013
Debt securities – unlisted	160,901	160,901	-	-	-
Collective investment schemes – unlisted	326,683	266,538	-	-	60,145
Cash and cash equivalents	67,591	65,860	1,731	-	-
Total	799,319	493,299	10,101	2,761	293,158

Included in the loans and receivables balance above is £0 546m in respect of assets that were 3-12 months past due but not impaired at the reporting date (2012 £0 089m, 3-12 months)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

25 Risk management (continued)

The table below analyses financial assets subject to credit risk using Moody's or equivalent

Financial assets held at fair value through profit or loss:

As at 31 December 2012

	Total £000	AAA £000	AA/A £000	B £000	Not Rated £000
Assets arising from reinsurance contracts held	10,352	-	10,352	-	-
Loans and Receivables	243,316	-	464	1,374	241,478
Debt securities – unlisted (note 7)	178,461	178,461	-	-	-
Collective investment schemes – unlisted	289,529	231,385	-	-	58,144
Cash and Cash Equivalents	128,921	59,570	69,351	-	-
Total	850,579	469,416	80,167	1,374	299,622

(4) Concentration risk*Credit concentration risk*

Credit concentration risk relates to the inadequate diversification of credit risk

Credit risk is managed through the setting and regular review of counterparty credit and concentration limits on asset types which are considered more likely to lead to a concentration of credit risk. For other asset types, such as investments in funds falling under the UCITS Directive, no limits are prescribed as the risk of credit concentration is deemed to be immaterial. This policy supports the approach mandated by the PRA for regulatory reporting.

At 31 December 2013 and 31 December 2012, the Company did not have any significant concentration of credit risk with a single counterparty or groups of counterparties where limits applied.

Liquidity concentration risk

Liquidity concentration risk arises where the Company is unable to meet its obligations as they fall due or do so only at an excessive cost, due to over-concentration of investments in particular financial assets or classes of financial asset.

As most of the Company's invested assets are diversified across a range of financial assets, including diversified funds falling under the UCITS Directive, it is unlikely that a material concentration of liquidity could arise.

This is supplemented by active liquidity management in the Company, to ensure that even under stress conditions the Company has sufficient liquidity as required to meet its obligations. This is delegated by the Board to and monitored through the IFCC.

(5) Financial soundness risk

Financial soundness risk covers the risk of financial failure, reputational loss or loss of earnings and/or value arising from a lack of liquidity, funding or capital and/or the inappropriate recording, reporting or disclosure of financial, taxation and regulatory information.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

25 Risk management (continued)

(i) Financial and prudential regulatory reporting, tax and disclosure risks

The Company is exposed to the risk that policies and procedures are not sufficient to maintain adequate books and records to support statutory, regulatory and tax reporting and to prevent and detect financial reporting fraud

The Company has developed procedures to ensure that compliance with both the current and potential future requirements are understood and that policies are aligned to its risk appetite. The Company has established a system of internal controls the objective of which is to provide reasonable assurance that transactions are recorded and undertaken in accordance with delegated authorities that permit the preparation and disclosure of financial statements, regulatory reporting and tax returns in accordance with IFRSs, statutory and regulatory requirements

The Company undertakes a programme of work designed to support an annual assessment of the effectiveness of internal controls over financial reporting, to identify tax liabilities and to assess emerging legislation and regulation

(ii) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in raising funds to meet its financial commitments as they fall due, or can secure them only at an excessive cost. Liquidity risk may result from either the inability to sell financial assets quickly at their fair values, or from an insurance liability falling due for payment earlier than expected, or from the inability to generate cash inflows as anticipated

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

For shareholder funds, liquidity risk is managed in line with the Insurance Liquidity Risk Policy and the wider LBG Funding and Liquidity Risk Policy

The following table 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

As at 31 December 2013

	Total £000	Up to 3 months £000	3-12 months £000	1-2 years £000	More than 2 years £000
Short-term insurance contracts	153,227	26,737	36,289	57,275	32,926
Other financial liabilities and accruals	99,015	99,015	-	-	-
Total	252,242	125,752	36,289	57,275	32,926

As at 31 December 2012

	Total £000	Up to 3 months £000	3-12 months £000	1-2 years £000	More than 2 years £000
Short-term insurance contracts	158,933	61,854	65,611	19,018	12,450
Other financial liabilities and accruals	65,172	65,172	-	-	-
Total	224,105	127,026	65,611	19,018	12,450

Short-term insurance contracts include claims reported and loss adjustment expenses, claims incurred but not reported and unexpired risk reserve as disclosed in note 17

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

25. Risk management (continued)

(iii) Capital Risk

Capital risk is defined as the risk that

- the Company has insufficient capital to meet its regulatory capital requirements,
- the Company has insufficient capital to provide a stable resource to absorb all losses up to a confidence level defined in the risk appetite,
- the Company loses reputational status by having capital that is regarded as inappropriate, either in quantity, type or distribution, and/or
- the capital structure is inefficient

The Company is regulated by the PRA. The PRA specifies the minimum amount of regulatory capital that must be held by the Company

Under the PRA rules, the Company must hold regulatory capital in excess of the higher of

- the Pillar 1 amount, known as the Minimum Capital Requirement (MCR), the calculation for which is set out in the PRA rules, and
- the Pillar 2 amount, known as Individual Capital Guidance, which is derived from an economic capital assessment undertaken by each regulated company, which is reviewed by the PRA

The minimum required capital must be maintained at all times throughout the year. These capital requirements and the capital available to meet them are regularly estimated in order to ensure that capital maintenance requirements are being met.

In addition capital requirements and capital available under Solvency II are estimated in order to ensure that Solvency II capital requirements will be met when Solvency II is introduced.

The Company's objectives when managing capital are

- to have sufficient 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,
- to comply with the insurance capital requirements set out by the PRA in the UK, and
- when capital is needed, to require an adequate return to the shareholder by pricing insurance contracts according to the level of risk associated with the business written.

The capital management strategy is such that the single integrated insurance business (comprising Scottish Widows Group ("SWG") and its subsidiaries, including the Company) will hold capital in line with the stated risk appetite for the business, which is to be able to withstand a one in ten year stress event without breaching the capital requirements. At SWG level it is intended that all surplus capital above that required to absorb a one in ten year stress event will be distributed to LBG.

The Company's capital comprises all components of equity, movements in which are set out in the statement of changes in equity.

The table below sets out the regulatory capital and the required capital held at 31 December in each year on a Pillar 1 basis. The current year information is taken from the final PRA return.

	2013 £000	2012 £000
Available capital	233,796	252,020
Capital requirement (MCR)	92,533	92,533
Regulatory surplus	141,263	159,487

All minimum regulatory requirements were met during the year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

25 Risk management (continued)**(d) 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

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 LBG as a whole manages its customer relationships affects all aspects of the Group's operations and is closely aligned with achievement of LBG'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

People risk

The risk of reductions in earnings and/or value through financial or reputational loss arising from ineffectively leading colleagues responsibly and proficiently, managing people resource, supporting and developing colleague talent, or meeting regulatory obligations related to our people

Financial crime and security risk

Financial crime risk covers the risk of reduction in earnings and/or value, through financial or reputational loss, associated with financial crime and failure to comply with related regulatory obligations, these losses may include censure, fines or the cost of litigation. This includes risks associated with fraud and bribery, and obligations related to money laundering, sanctions and counter terrorism

Security risk relates to 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. This also includes risks relating to terrorist acts, other acts of war, geopolitical, pandemic or other such events

Organisational infrastructure and change risk

Organisational infrastructure risk covers the risk of reductions in earnings and/or value, through financial or reputational loss, resulting from poor internally facing business processes at a Group, divisional or company level. Organisational infrastructure in this context embraces the structures, systems and processes that provide direction, control and accountability for the enterprise. Change risk comprises the risk of potential loss from change initiatives failing to deliver to requirements, budget or timescale, failing to implement change effectively or failing to realise desired benefits

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 Euro zone 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. The impact of a 'yes' vote in favour of Scottish independence is uncertain. The outcome could have a material impact on compliance costs, the tax position, and cost of funding for the Company. Key mitigating actions include monitoring and assessment of the potential impact on the Company's business and impact on customers of a vote in favour of Scottish independence

Supplier management risk

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

25 Risk management (continued)**IT systems risk**

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

The Directors have approved a risk framework and monitor the effective operation of this across the Group

(e) Legal and regulatory risk

Legal and regulatory risk is the risk of reductions in earnings and/or value, through financial or reputational loss, from failing to comply with the applicable laws, regulations or codes

The volume of actual and expected regulatory change remains high and work is ongoing to review, assess and embed new regulatory requirements into day-to-day operational and business practices across the Company

Regulators are interested in protecting the rights of the policyholders and ensuring that the Company is satisfactorily managing affairs for the benefit of the policyholders. Regulators are also keen to ensure that the Company maintains appropriate solvency levels to meet unforeseen liabilities arising from reasonably foreseeable economic shocks or natural disasters. As such, the Company is subject to regulatory requirements which prescribe and impose certain restrictive provisions

The Group monitor and manage all legal and regulatory risks closely and have regulator interaction with the regulators

26. Contingencies and commitments

Except as stated in note 19, in the opinion of the directors, there were no material contingent liabilities or commitments requiring disclosure (2012 £nil)

27 Related party transactions

The immediate parent undertaking is Lloyds Bank General Insurance Holdings Limited (previously "Lloyds TSB General Insurance Holdings Limited")

The parent undertaking which is the parent undertaking of the smallest group to consolidate these financial statements is Lloyds Bank plc. Copies of the consolidated annual report and financial statements of Lloyds Bank plc may be obtained from Insurance Secretariat, 69 Morrison Street, Edinburgh EH3 8YF

The ultimate parent undertaking and controlling party is Lloyds Banking Group plc, which is the parent undertaking of the largest group to consolidate these financial statements. Copies of the consolidated annual report and financial statements of Lloyds Banking Group plc may be obtained from Lloyds Banking Group's head office at 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

27 Related party transactions (continued)

Relationship	Transactions in the Year		Outstanding Balance at 31 December	
	2013 £ 000	2012 £ 000	2013 £ 000	2012 £ 000
Parent Companies				
Dividend paid	99,000	32,000	-	-
Holdings in collective investment schemes	-	-	3,869	3,364
Cash and cash equivalents and Interest Income	145	2,912	1,731	69,343
Group relief for income tax	-	-	22,481	73,133
Fellow Group subsidiaries.				
Investment income in assets held at fair value	185	90	266,538	231,385
Commission and amounts payable	145,454	92,952	-	-
Services of key management	408	585	-	-
Investment management fees	341	469	-	-
Other management services	86,663	84,283	60,929	22,563
Cash and cash equivalents and interest income	311	80	65,860	59,570

In 2013, this table has been reformatted to align with other group entities for the purpose of clearer presentation

Transactions between the Company and key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company which, for the Company, are the Company's Directors

Transactions between the key management personnel of the Company and parties related to them as defined by IAS 24 are as follows

	2013 £000	2012 £000
Salaries and other short-term employee benefits	320	483
Post-employment benefits	9	27
Share-based payments	80	75
Termination benefits	-	32
Total	409	617

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

No retirement benefits are accruing to Directors and key management personnel (2012: nil) under defined benefit pension schemes. Six Directors and key management personnel (2012: fifteen) are paying into a defined contribution scheme

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

27 Related-party transactions (continued)

Transactions between the Company and key management personnel (continued)

Detail regarding the highest paid Director is as follows

Detail regarding the highest paid director

	2013 £000	2012 £000
Apportioned aggregate emoluments	50	91
Contributions paid to money purchase pension schemes	2	13

The highest paid Director did not exercise share options in 2013 (2012 nil) but was granted shares in respect of qualifying service during the year. This was also the case in the prior year. These have been disclosed in the LBG consolidated financial statements.

Other Transactions

HM Treasury

In January 2009, HM Treasury became a related party of the Company following its subscription for ordinary shares in LBG, the Company's ultimate parent company, issued under a placing and open offer. As at 31 December 2013, HM Treasury held a 32.7 percent (2012 39.2 per cent) interest in LBG's ordinary share capital and, consequently, HM Treasury remained a related party of the Company throughout 2012.

There were no material transactions between the Company and HM Treasury during the year (2012 none) that were not made in the ordinary course of business or that are unusual in their nature or conditions. In addition, the Company has entered into transactions with HM Treasury on an arm's length basis including, but not exclusively in relation to, the payment of corporation tax, employment tax, and value added tax.

28. Standards and interpretations effective in 2013

(i) IFRS 12 "Disclosure of Interests in Other Entities"

IFRS 12 requires an entity to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. These changes relate only to disclosure and have had no overall impact on the financial results or position of the Company.

The standard has resulted in an increase in disclosure, in particular on structured entities. The Company has interests in unconsolidated structured entities arising from investment in collective investment schemes. The Company has expanded the disclosures about interests in unconsolidated structured entities to reflect the new disclosure requirements, as set out in note 14.

(ii) IFRS 13 "Fair Value Measurement"

IFRS 13 defines fair value, sets out a framework for measuring fair value and requires disclosures about fair value measurements. It applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements. This standard has not had a material impact on the financial statements.

(iii) Amendments to IFRS 7 "Financial Instruments: Disclosures" – 'Offsetting Financial Assets and Financial Liabilities'

The amendments to IFRS 7 require an entity to disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the entity's balance sheet. These changes relate only to disclosure and have had no overall impact on the financial results or position of the Company. This standard has not had a material impact on the financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

28 Standards and interpretations effective in 2013 (continued)

(iv) Amendments to IAS 1 "Presentation of Financial Statements" – 'Presentation of Items of Other Comprehensive Income'

The amendments to IAS 1 require entities to group items presented in other comprehensive income on the basis of whether they are potentially reclassified to profit or loss subsequently. These changes relate only to presentation and have had no overall impact on the financial results or position of the Company. This standard has not had a material impact on the financial statements.

Details of those IFRSs pronouncements which will be relevant to the Company but which were not effective at 31 December 2013 and which have not been applied in preparing these financial statements are given in note 29.

29 Future accounting developments

The following pronouncements may have a significant effect on the Company's financial statements but are not applicable for the year ending 31 December 2013 and have not been applied in preparing these financial statements. Except as disclosed below, the full impact of these accounting changes is being assessed by the Company.

Pronouncement	Nature of change	IASB effective date
IFRS 9, 'Financial instruments' ^{1&2}	Replace those parts of IAS 39 'Financial Instruments Recognition and Measurement' relating to the classification, measurement and derecognition of financial assets and liabilities. IFRS 9 requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instrument, and eliminates the available-for-sale financial asset and held-to-maturity investment categories in IAS 39. The requirements for derecognition are broadly unchanged from IAS 39. The standard also retains most of the IAS 39 requirements for financial liabilities except for those designated at fair value through profit or loss whereby the part of the fair value change attributable to the entity's own credit risk is recorded in other comprehensive income.	Not yet determined
Amendments to IAS 32 "Financial Instruments Presentation" – 'Offsetting Financial Assets and Financial Liabilities'	Inserts application guidance to address inconsistencies identified in applying the offsetting criteria used in the standard. Some gross settlement systems may qualify for offsetting where they exhibit certain characteristics akin to net settlement.	Annual periods beginning on or after 1 January 2014
IFRIC 21 "Levies" ¹	The interpretation provides guidance on the accounting for levies if the liability is within the scope of IAS 37. A levy is imposed on entities by governments in accordance with legislation, but excludes those that are in the scope of other standards, such as income taxes, and fines and penalties from breaches of legislation.	Annual periods beginning on or after 1 January 2014

¹ At the date of this report, these pronouncements are awaiting EU endorsement.

² IFRS 9 is the standard which will replace IAS 39. Further changes to IFRS 9 are expected dealing with impairment of financial assets measured at amortised cost, which will be based on expected rather than incurred credit losses, and limited amendments to classification and measurement which include the introduction of a third measurement category, fair value through other comprehensive income. Until the standard is complete, it is not possible to determine the overall impact of the standard on the financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

30 Post balance sheet event

In February 2014 a collateralised loan agreement was signed by the Board authorising a collateralised loan of £100m to a related party. In March 2014, the Company made a loan of £100m to a related party against which collateral is held. The collateral includes asset backed securities and covered bonds with fair value of at least 130% of the cash lent. Collateral amounts held are not recognised as assets.