LLOYDS BANK GENERAL INSURANCE LIMITED

ANNUAL REPORT

AND

FINANCIAL STATEMENTS

31 DECEMBER 2016

Member of Lloyds Banking Group plc

CONTENTS

COMPANY INFORMATION

Board of Directors

N E T Prettejohn (Chairman)

A M Blance
M Christophers
K A Cook
M G Culmer
J E M Curtis
M Harris*
J F Hylands
A Lorenzo*
V Maru
R L M Wohanka

* denotes Executive Director

Company Secretary

J M Jolly

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

00204373

STRATEGIC REPORT

The Directors present their Strategic Report on Lloyds Bank General Insurance Limited ("the Company") for the year ended 31 December 2016.

The Company forms part of the General Insurance business unit within the Insurance Division of Lloyds Banking Group ("Insurance"), focusing on providing general insurance to meet our customers needs.

Our strategy to help our customers is by:

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

As part of the Insurance Division strategy, the Company underwrites General Insurance, including home insurance, creditor insurance, pet insurance, accident and health insurance marketed primarily under the Lloyds Bank, Bank of Scotland and Halifax brands and sold predominantly through LBG and corporate partnerships. The Company is focused on investing in the growth of its customer base and ensuring policyholder obligations are met, while 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 focused 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.

Principal activities

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

Result and dividends for the year

The result of the Company for the year ended 31 December 2016 is a profit before tax of £44m (2015: £71m).

Interim dividends of £65m were paid during the year in respect of 2016 (2015: £nil).

Britain leaving the EU

The Company is part of the wider LBG, and, at that level, consideration of many of the potential implications following the UK's vote to leave the European Union has been undertaken. Work continues to assess the impact of the EU exit at the level of the LBG, as well as for the Company, upon customers, colleagues and products. This assessment includes all legal, regulatory, tax, finance and capital implications.

Key performance indicators

Net insurance premiums

Net insurance premiums increased by 6% to £586m in 2016 (2015: £552m), the increase was due to unearned premium releases offsetting lower gross premiums due to changes in process and productivity within the LBG bank branch network.

Claims and loss adjustment expenses

Claims and loss adjustment expenses increased by 16% to £269m (2015: £232m). Current year claims and loss adjustment costs reflect the increased file size offset by lower weather related claims. A number of perils have seen some adverse development in relation to prior years.

STRATEGIC REPORT (continued)

Combined ratio

The Company's combined ratio has increased by 7% to 95% (2015: 88%). This reflects the increase in claims during the year and increased expenses due to the payment of the Flood Re levy.

Solvency II

Solvency II came into force on 1 January 2016. Through preparation for Solvency II in previous years, the Company had already embedded Solvency II into decision making. The wider Insurance Division has agreed with the PRA to submit a single Own Risk and Solvency Assessment ("ORSA") covering the group headed by Scottish Widows Group Limited ("SWG"), and the assessment of own risks and solvency needs of the Company is therefore covered by that assessment. The ORSA report for 2016 will be submitted to the PRA by May 2017.

The Directors believe that the Company currently have adequate capital resources and will continue to do so in the foreseeable future. On a Solvency II basis the estimated regulatory surplus of the Company in excess of capital requirements is £156m (2015: £125m).

The estimated pre dividend Solvency II ratio for the Company of 155 per cent (1 January 2016 pre dividend position: 141 per cent) represents the shareholder view of Solvency II surplus. Further information on the capital position of the Company is given in note 24.

During the year, the Company has successfully implemented and delivered Solvency II reporting in respect of the opening Solvency II Balance Sheet and solvency position at 1 January 2016, and subsequent quantitative quarterly reporting to the PRA. Work is continuing to prepare for submission of full annual quantitative reporting for 31 December 2016, as well as the first narrative reporting required by Solvency II. The Company has a waiver from the PRA to report publicly in the Scottish Widows Group Limited single Solvency and Financial Condition Report (SFCR), which is due to be published by 1 July 2017. The Regular Supervisory Report (RSR) for the Company, privately reported to the PRA, is due in May 2017.

Liquidity

The Company regularly monitors its liquidity position to ensure that, even under stressed conditions, the Company has sufficient liquidity to meet its obligations and remains within approved risk appetite.

Other sources

The Company also forms part of the 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 Solvency II reporting 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.

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. Decisions taken in the areas described below and in pursuit of our strategy are brought to life for the Board through the ORSA completed annually.

STRATEGIC REPORT (continued)

Investment strategy

As part of its efficient Balance Sheet management, the Insurance Division is focused on investments that improve risk adjusted returns and provide more diversification of assets to match its liabilities. In particular, the Insurance Division continues to identify investment opportunities in long term, low risk, higher yielding illiquid assets available within LBG and developing the Company's capability to originate new loan assets, leveraging the capabilities of LBG as appropriate. This is expected to continue to deliver significant increased investment return to the Insurance Division without increasing credit risk beyond the risk appetite.

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.

GI simplification initiative

The GI simplification initiative will change the intra general insurance cost allocations and internal commission payments so that, going forward, all risks and rewards in respect of business underwritten by the Company are no longer split with Lloyds Bank Insurance Services Limited.

These changes will be implemented from 1st January 2017 and will be reflected in the acquisition and administration expenses lines within the Statement of Comprehensive Income.

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 and operational risks 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.

The Company, like other insurers, is subject to legal proceedings in the normal course of business. Whilst it is not practicable to forecast or determine the final results of all pending or threatened legal proceedings, management does not believe that such proceedings, including litigation, will have a material effect on the results and financial position of the Company.

On behalf of the Board of Directors

M Harris
Director
23 March 2017

DIRECTORS' REPORT

Lloyds Bank General Insurance Limited ("the Company") is a company limited by shares, domiciled and incorporated in the United Kingdom.

Principal activities

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, Bank of Scotland and Halifax brands and sold predominantly through LBG and corporate partnerships.

Results and dividend

The result of the Company for the year ended 31 December 2016 is a profit before tax of £44m (2015: £71m).

During the year £65m of interim dividends were paid (2015: £nil). The Directors recommend no payment of a dividend in respect of the year ended 31 December 2016 (2015: £nil).

Directors

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

Changes in directorships during the year and since the end of the year are as follows:

A Parsons	(Resigned 1 September 2016)
C Thornton	(Resigned 8 November 2016)
A Lorenzo	(Appointed 2 March 2016)
M Harris	(Appointed 1 September 2016)

Particulars of the Directors' emoluments are set out in note 27.

Director's indemnities

LBG 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 LBG. 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

Each person who is a Director at the date of approval of this report confirms that, so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware and 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.

Future developments

Future developments are detailed within the Strategic Report and also on page 47.

Political contributions

During the year, the Company made no political contributions (2015: nil).

Going concern

The going concern of the Company is dependent on successfully maintaining adequate levels of capital and liquidity. In order to satisfy themselves that the Company has adequate resources to continue to operate for the foreseeable future, the Directors have considered a number of key dependencies which are set out in the risk management note 25. Having consulted on these, the Directors conclude that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

DIRECTORS' REPORT (continued)

Financial risk management

Disclosures relating to financial risk management are included in note 25 to the accounts and are therefore incorporated into this report by reference.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual 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 ("IFRS") 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 IFRS as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements and;
- prepare the financial statements on 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 IFRS 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

M Harris
Director
23 March 2017

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

Report on the financial statements

Our opinion

In our opinion, Lloyds Bank General Insurance Limited's financial statements (the "financial statements"):

- give a true and fair view of the state of the Company's affairs as at 31 December 2016 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.

What we have audited

The financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), comprise:

- the Balance Sheet as at 31 December 2016;
- the Statement of Comprehensive Income for the year then ended;
- the Statement of Cash Flows for the year then ended;
- the Statement of Changes in Equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union, and applicable law.

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.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

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 kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' *remuneration*

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

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

Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors

As explained more fully in the Statement of Directors' Responsibilities 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 International Standards on Auditing (UK and Ireland) ("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.

What an audit of financial statements involves

We conducted our audit in accordance with 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.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report 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. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.

David Roper

David Roper (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Birmingham

24 March 2017

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016

	Notes	2016 £000	2015 £000
Revenue			
Gross earned premiums	3	604,248	563,698
Premiums ceded to reinsurers	3	(18,285)	(12,093)
Premiums net of reinsurance		585,963	551,605
Net investment income	4	4,955	3,165
Net gains on assets at fair value through profit or loss	5	4,834	2,581
Total revenue		595,752	557,351
Claims and loss adjustment costs recoverable from reinsurers			
Claims and loss adjustment costs	6	(268,818)	(232,393)
Claims and loss adjustment costs recoverable from reinsurers	6	5	-
Claims and loss adjustment costs		(268,813)	(232,393)
Expenses			
Expenses for the acquisition of insurance contracts	7	(203,950)	(200,094)
Expenses for administration	7	(79,361)	(53,873)
Expenses		(283,311)	(253,967)
Total expenses		(552,124)	(486,360)
Profit before tax		43,628	70,991
Taxation charge	9	(8,360)	(13,386)
Profit for the year		35,268	57,605

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 49 form an integral part of these financial statements.

BALANCE SHEET AS AT 31 DECEMBER 2016

	Notes	2016 £000	2015 £000
ASSETS			
Intangible insurance assets	10	84,257	87,741
Reinsurance assets	11	10,374	8,047
Financial assets:			
Loans and receivables	12	301,254	326,008
Investments at fair value through profit or loss	13	524,152	406,862
Cash and cash equivalents	14	143,683	238,489
Total assets		1,063,720	1,067,147
EQUITY AND LIABILITIES			
Capital and reserves attributable to the Company's equity shareholder			
Share capital	15	86,700	86,700
Retained earnings		360,582	390,314
Total equity		447,282	477,014
LIABILITIES			
Insurance contracts	16	418,055	455,495
Deferred tax liabilities	17	14,920	18,538
Current tax payables	17	11,978	13,265
Provisions for other liabilities and charges	18	5,125	5,025
Accruals	19	915	2,806
Financial liabilities:			
Other financial liabilities	20	156,056	95,004
Borrowings	21	9,389	-
Total liabilities		616,438	590,133
Total equity and liabilities		1,063,720	1,067,147

The notes on pages 15 to 49 form an integral part of these financial statements.

The financial statements on pages 11 to 49 were approved by the Board on 23 March 2017.

M Harris
Director

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2016

	Notes	2016 £000	2015 £000
Cash flows from operating activities			
Profit before tax		43,628	70,991
Adjusted for:			
Investment income and net fair value gains on assets held at fair value through profit or loss		(9,789)	(5,746)
Net decrease in operating assets and liabilities	22	47,732	72,255
Taxation paid		(13,264)	(22,873)
Net cash flows from operating activities		68,307	114,627
Cash flows used in investing activities			
Net (increase) of investments at fair value through profit or loss		(112,457)	(79,931)
Interest received	4	1,343	3,165
Dividend and other income received	4	3,612	2,581
Net cash flows used in investing activities		(107,502)	(74,185)
Cash flows used in financing activities			
Dividends paid	23	(65,000)	-
Net cash flows used in financing activities		(65,000)	-
Net (decrease)/increase in cash and cash equivalents		(104,195)	40,442
Cash and cash equivalents at the beginning of the year	14, 21	238,489	198,047
Net cash and cash equivalents at the end of the year	14, 21	134,294	238,489

The notes on pages 15 to 49 form an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016

	Notes	Share capital £000	Retained earnings £000	Total equity £000
Balance at 1 January 2015		86,700	332,709	419,409
Profit for the year and total comprehensive income for the year		-	57,605	57,605
Balance at 31 December 2015		86,700	390,314	477,014
Profit for the year and total comprehensive income for the year		-	35,268	35,268
Dividends paid	23	-	(65,000)	(65,000)
Balance at 31 December 2016		86,700	360,582	447,282

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 49 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

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 IFRS Interpretations Committee ("IFRS IC"), as endorsed by the European Union;

(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.

The Company forms part of LBG, which prepares a group set of consolidated financial statements under IFRS.

Standards and interpretations effective in 2016

The Company has not adopted any new standards, amendments to standards and interpretations of published standards which became effective financial years beginning on or after 1 January 2016, which have had a material impact on the Company.

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

(b) Insurance contracts

Insurance contracts are those contracts which transfer significant insurance risk. Such contracts may also transfer financial risk. As a general guideline, the Company defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event which are 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.

(c) 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 (i) and (r) respectively). The classification depends on the purpose for which financial assets and financial liabilities were acquired.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

1. Accounting policies (continued)

(c) Financial assets and financial liabilities (continued)

Certain financial assets and financial liabilities, whose default accounting treatment would be to record these balances at amortised cost, are instead designated at fair value through profit or loss as they are held to match insurance and investment contract liabilities linked to the changes in fair value of these assets and liabilities, thereby reducing measurement inconsistencies, and reflecting the fact that these are managed and their performance evaluated on a fair value basis. Information on these balances 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, loans, investment property, derivatives and cash and to evaluate the Company's investments with reference to their fair values.

(d) 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 LBG considers that market participants would use in pricing the asset or liability, for example private equity investments held by LBG and 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. LBG's management, through the Insurance Fair Value Pricing Committee, review information on the fair value of LBG'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, both in the normal course of business and in the event of default, and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

1. Accounting policies (continued)

(d) Fair value methodology (continued)

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.

(e) 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 the right to receive the dividend is established. 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.

(f) Expense recognition

Claims and loss adjustment expenses

Claims and loss adjustment expenses, including claims handling 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 (g).

Other operating expenses are recognised in the Statement of Comprehensive Income as incurred, within expenses for administration.

(g) 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 2016

1. Accounting policies (continued)

(h) Assets arising from reinsurance contracts held

The Company cedes reinsurance in the normal course of business. Where the reinsurance contract transfers significant insurance risk to the reinsurer, the assets arising from reinsurance contracts held are classified as insurance contracts. Where the reinsurance contract does not transfer significant insurance risk to the reinsurer, the assets arising from reinsurance contracts held are classified as a financial asset designated as fair value through profit or loss.

Assets arising from reinsurance contracts held – classified as insurance contracts

These assets are recognised within assets arising from reinsurance contracts held. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the underlying contracts and in accordance with the terms of each reinsurance contract. These balances are subject to an annual impairment review. Further information on the Company's impairment policy is set out at policy (l).

Changes in these assets are recognised on the face of the statement of comprehensive income, through change in assets arising from reinsurance contracts held.

Premiums ceded and claims reimbursed are recognised when due and disclosed separately on the face of the Statement of Comprehensive Income. Changes in these assets are recognised on the face of the Statement of Comprehensive Income, through change in assets arising from reinsurance contracts held.

Assets arising from reinsurance contracts held – at fair value through profit or loss

Amounts due from reinsurers in respect of contracts that do not transfer significant insurance risk to the reinsurer are designated as fair value through profit or loss as this ensures consistency of valuation with the underlying liabilities. These contracts, whilst legally reinsurance contracts, do not meet the definition of a reinsurance contract under IFRS. Where this is the case, the amounts recoverable have been recognised as a financial asset within assets arising from reinsurance contracts held. Changes in these assets are recognised on the face of the Statement of Comprehensive Income, through change in assets arising from reinsurance contracts held. These balances are subject to an annual impairment review. Further information on the Company's impairment policy is set out at policy (l).

(i) 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 operating expenses in that part of the Statement of Comprehensive Income. 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. Such amounts are reflected through the Statement of Comprehensive Income.

(j) Investments at fair value through profit or loss

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

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

1. Accounting policies (continued)

(j) Investments at fair value through profit and loss (continued)

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.

For equity investments that are quoted and actively traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices at the final pricing point on the reporting date. Prices are provided by vendors such as Reuters or Bloomberg or by direct reference to the Stock Exchange.

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.

The fair value of holdings in collective investment vehicles (including OEICs and Unit Trusts) is determined as the last published price applicable to the vehicle at the reporting date.

For equity investments such as private equity, fair value is determined by reference to the most recent valuation, adjusted for any cash movements or other relevant information since the last valuation point, which is likely to be up to one quarter prior to the reporting date.

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.

Structured entities

The Company invests in structured entities arising from investments in investment properties held through limited partnerships. The unconsolidated limited partnerships are initially recognised at cost, being the fair value of the consideration given. After initial recognition, such assets are accounted for and measured at fair value, which equates to the relevant proportion of the published net asset value of the company. This valuation is based on open market valuations of the properties held by the limited partnership, as provided at the reporting date by independent values.

The Company holds investments in structured entities arising from investments in collective investment vehicles. Unconsolidated collective investment vehicles are carried at fair value.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

1. Accounting policies (continued)

(k) Cash and cash equivalents

Cash and cash equivalents includes cash at bank, short-term highly liquid investments with original maturities of three months or less (excluding such investments as otherwise meet this definition but which are held for investment purposes rather than for the purposes of meeting short-term cash commitments) and bank overdrafts where a legal right of set off exists.

(l) 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 the present value of estimated future cash flows discounted at the asset's original effective interest rate.

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 receivables; 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

1. Accounting policies (continued)

(m) 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 tax

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date. However, if the deferred tax arises from initial recognition of an asset or liability in a transaction other than a business combination that, at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. 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 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 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 tax asset to be utilised. Deferred tax assets and liabilities held are undiscounted.

(n) Share capital

Shares are classified as equity when there is no obligation to transfer cash or other assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

Dividends payable

Dividends payable on ordinary shares are recognised in equity in the year in which they are approved.

(o) 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: home, creditor, accident and health, and pet.

Home 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).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

1. Accounting policies (continued)

(o) Insurance contracts (continued)

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.

(p) 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.

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.

(q) 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.

(r) 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

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 judgments 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.

Insurance contract liabilities

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, home 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. Hence the estimation of the ultimate cost of subsidence claims is complex.

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.

3. Premiums net of reinsurance

	2016 £000	2015 £000
Short-term insurance contracts		
- premiums receivable (note 16)	570,797	621,642
- change in unearned premium reserve	33,451	(57,944)
Total gross earned premiums (note 16)	604,248	563,698
Short-term reinsurance contracts		
- premiums payable (note 16)	(20,611)	(15,709)
- change in unearned premium reserve	2,326	3,616
Total premiums ceded to reinsurers	(18,285)	(12,093)
Total premiums net of reinsurance	585,963	551,605

4. Net investment income

	2016 £000	2015 £000
Net income on investments designated at fair value through profit or loss	3,612	2,318
Other interest income	1,343	847
Total	4,955	3,165

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

	2016 £000	2015 £000
Net gains on assets at fair value through profit or loss	4,834	2,581
Total	4,834	2,581

Net fair value gains on assets held at fair value through profit or loss include net realised gains of £0.4m (2015: gains of £5.5m) and net unrealised gains of £4.4m (2015: losses of £5.6m).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

6. Claims and loss adjustment costs

	£000	2016 £000	£000	£000	2015 £000	£000
	Gross	*Reinsurance*	*Net*	*Gross*	*Reinsurance*	*Net*
Current year claims and loss adjustment costs (note 16)	270,905	-	270,905	254,924	-	254,924
Movement in costs of prior year claims and loss adjustment costs (note 16)	(1,873)	(5)	(1,878)	(20,700)	-	(20,700)
Movement in the expected cost of claims for unexpired risks (note 16)	(214)	-	(214)	(1,831)	-	(1,831)
Total claims and loss adjustment costs	268,818	(5)	268,813	232,393	-	232,393

In order to improve presentation for the 2015 comparative, £13.7m that was previously presented within Movement in costs of prior year claims and loss adjustment costs has been reallocated to Current year claims and loss adjustment costs.

7. Operating expenses

	2016 £000	2015 £000
Fees and commissions payable	184,415	211,963
Acquisition expenses	16,051	14,925
Change in gross deferred acquisition costs	3,484	(26,794)
Expenses for the acquisition of insurance contracts	203,950	200,094
Expenses for administration	79,361	53,873
Total	283,311	253,967

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 2016 operating expenses recharged to the Company were £86.0m (2015: £61.4m). In 2016 claims handling expenses of £46.4m (2015: £44.0m) were allocated to insurance claims costs.

The Company had no direct employees during the year (2015: nil). Employee costs, including pension costs and share-based payment costs, are included in the recharge noted above.

8. Auditors' remuneration

	2016 £000	2015 £000
Audit fees		
Fees payable to the Company's auditor for the audit of the Company's annual financial statements	208	226
Fees payable to the Company's auditor and its associates for other services:		
Fees in relation to SII work	113	115
Non-audit services pursuant to regulation	-	28
Total	321	369

Audit fees are borne by another company within the group and recharged to the Company.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

9. Taxation charge

(a) Current year tax charge

	2016 £000	2015 £000
Current tax:		
UK corporation tax	11,978	13,265
Total current tax	11,978	13,265
Deferred tax:		
Deferred tax (credit)/charge (note 17)	(3,618)	121
Total deferred tax (credit)/charge	(3,618)	121
Total income tax charge for the year	8,360	13,386

(b) Reconciliation of tax charge

	2016 £000	2015 £000
Profit before tax	43,628	70,991
Tax charge at effective UK corporation rate of 20% (2015: 20.25%)	8,726	14,376
Effects of:		
Rate change and related impacts	(366)	(990)
Total	8,360	13,386

The charge for income taxation on the profit for the year is based on an effective United Kingdom corporation taxation rate of 20% (2015: 20.25%) as the standard corporation taxation rate changed from 21% to 20% effective 1 April 2015.

The effective tax rate for the year is 19.2% (2015: 18.9%).

The Finance Act 2013 which was substantively enacted on 2 July 2013 reduced the main rate of corporation tax to 21% with effect from 1 April 2014 and 20% with effect from 1 April 2015.

10. Intangible insurance assets

Deferred acquisition costs	2016 £000	2015 £000
At 1 January	87,741	60,947
Additions	185,858	226,889
Amortisation through Statement of Comprehensive Income	(189,342)	(200,095)
At 31 December	84,257	87,741

Of the above total £0.5m (2015: £0.6m) is expected to be recovered more than one year after the reporting date.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

11. Reinsurance assets

	2016 £000	2015 £000
Reinsurers' unearned premium (note 16)	10,166	7,839
Reinsurers' share of claims reserves (note 16)	208	208
Reinsurance assets	10,374	8,047

Of the above £2.9m (2015: £58k) is expected to be recovered more than one year from the reporting date.

All of the above amounts relate to home contracts of insurance. The Reinsurers' share of claims reserves relates to creditor insurance.

12. Loans and receivables

	2016 £000	2015 £000
Receivables arising from insurance and reinsurance contracts:		
- due from contract holders	176,571	199,369
- due from related parties (note 27)	124,683	126,639
Total loans and receivables	301,254	326,008

Of the above total £301.3m (2015: £226.0m) is expected to be recovered less than one year after the reporting date.

In December 2016 the £100m loan with Scottish Widows Group was settled.

13. Investments at fair value through profit or loss

	2016 £000	2015 £000
Collective Investment Schemes – unlisted (note 27)	243,685	240,975
Debt securities – listed	250,853	98,456
Debt securities – unlisted	29,614	67,431
Total financial investments at fair value through profit or loss	524,152	406,862

Of the above total £280.5m (2015: £165.9m) 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 (Note 14) are investments in unconsolidated structured entities of £370.8m (2015: £456.7m) arising from investments in collective investment schemes and liquidity funds.

The collective investment schemes and liquidity funds 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.

At 31 December 2016, the total net assets of unconsolidated collective investment schemes in which the Company held a beneficial interest was £18.9bn (2015: £19.7bn). During the year the Company has not provided any non-contractual financial or other support to these unconsolidated collective investment schemes and liquidity funds.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

14. Cash and cash equivalents

Cash and cash equivalents for the purposes of the statement of cash flows include the following:

	2016 £000	2015 £000
Cash at bank and in hand	17,340	17,610
Aberdeen Liquidity fund (formerly "Global Liquidity Fund")	126,343	220,879
Bank overdraft	(9,389)	-
Total cash and cash equivalents for cash flow purposes	134,294	238,489
Less: Bank overdraft	9,389	-
Total cash and cash equivalents	143,683	238,489

During 2015, the Aberdeen Global Liquidity Fund plc ("GLF") was a managed investment fund (Collective Investment Scheme) investing in short term highly liquid investments and was managed by Aberdeen Asset Management plc. LBG held a controlling interest in the fund at 31 December 2015, and consolidated it as a subsidiary under IFRS 10. As a fellow group undertaking, the GLF was therefore a related party of the Company.

On the 15 July 2016 the GLF was transferred into the Aberdeen Liquidity Fund (Lux) ("ALF"). At 31 December 2016 the Company's ultimate parent company held a controlling interest in the ALF. Under IFRS 10, the ALF is a fellow group undertaking and therefore a related party of the Company.

The effective interest rate on cash and cash equivalents was 0.57% (2015: 0.47%)

15. Share capital

	2016 £000	2015 £000
Allotted, called up and fully paid ordinary share capital:		
At 1 January and 31 December		
Issued and fully paid – 86.7m shares of £1 each	86,700	86,700
Total	86,700	86,700

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.

16. Liabilities arising from insurance contracts

		2016			2015	
	£000	£000	£000	£000	£000	£000
	Gross	*Recoverable from reinsurers*	*Net*	*Gross*	*Recoverable from reinsurers*	*Net*
Short-term insurance contracts:						
Claims reported & loss adjustment costs	79,164	(208)	78,956	82,536	(208)	82,328
Claims incurred but not reported	50,201	-	50,201	50,604	-	50,604
Unexpired risk reserve	2,187	-	2,187	2,401	-	2,401
Unearned premiums	286,503	(10,166)	276,337	319,954	(7,839)	312,115
Total insurance liabilities	418,055	(10,374)	407,681	455,495	(8,047)	447,448

Of the above total £27.2m (2015: £30.1m) 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 2016 and 2015 are not material.

The unexpired risk reserve includes £2.2m (2015: £2.4m) in respect of the pet insurance business.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

16. Liabilities arising from insurance contracts (continued)

Movements in insurance liabilities and reinsurance assets

(a) Claims and loss adjustment expenses

		2016			2015	
	£000	£000	£000	£000	£000	£000
	Gross	*Reinsurance*	*Net*	*Gross*	*Reinsurance*	*Net*
Notified claims	82,536	(208)	82,328	101,260	(208)	101,052
Incurred but not reported	50,604	-	50,604	9,872	-	9,872
Total at beginning of year	133,140	(208)	132,932	111,132	(208)	110,924
Cash paid for claims settled in the year	(272,807)	5	(272,802)	(212,216)	-	(212,216)
Increase in liabilities						
- arising from current year claims (note 6)	270,905	-	270,905	254,924	-	254,924
- arising from prior year claims (note 6)	(1,873)	(5)	(1,878)	(20,700)	-	(20,700)
Total at end of year	129,365	(208)	129,157	133,140	(208)	132,932
Notified claims	79,164	(208)	78,956	82,536	(208)	82,328
Incurred but not reported	50,201	-	50,201	50,604	-	50,604
Total at end of year	129,365	(208)	129,157	133,140	(208)	132,932

There has been no significant change year on year in the assumptions and methodologies used for setting the best estimate reserves.

In order to improve presentation for the 2015 comparative, £13.7m that was previously presented within Increase in liabilities – arising from prior year has been reallocated to Increase in liabilities – arising from current year.

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

		2016			2015	
	£000	£000	£000	£000	£000	£000
	Gross	*Reinsurance*	*Net*	*Gross*	*Reinsurance*	*Net*
Unearned premiums						
At 1 January	319,954	(7,840)	312,114	262,010	(4,223)	257,787
Increase in the year (note 3)	570,797	(20,611)	550,186	621,642	(15,709)	605,933
Release in the year (note 3)	(604,248)	18,285	(585,963)	(563,698)	12,093	(551,605)
At 31 December	286,503	(10,166)	276,337	319,954	(7,839)	312,115
Unexpired risk reserve						
At 1 January	2,401	-	2,401	4,232	-	4,232
Increase in the year (note 6)				-	-	-
Release in the year (note 6)	(214)	-	(214)	(1,831)	-	(1,831)
At 31 December	2,187		2,187	2,401	-	2,401

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 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 2016

17. Tax liabilities

	2016 £000	2015 £000
Current tax payables	11,978	13,265
Deferred tax liabilities	14,920	18,538
Total tax liabilities	26,898	31,803

Of the deferred tax liabilities in the above table, £3.0m 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.

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

	2016 £000	2015 £000
Deferred tax liabilities comprise:		
Claims equalisation reserve ("CER") provision	14,920	18,538
Total deferred tax liabilities	14,920	18,538
Net deferred tax liabilities	14,920	18,538

Deferred income tax is calculated in full on temporary differences under the liability method using a tax rate of 18.35% (2015: 19%).

The tax charge in the Statement of Comprehensive Income relating to each of the above items is as follows:

	2016 £000	2015 £000
Claims equalisation reserve provision	(3,618)	121
Total deferred tax (credit)/charge	(3,618)	121

Finance Act 2012, s26 abolished relief for claims equalisation reserves with effect from an appointed day, confirmed as 1 January 2016 per Statutory Instrument 2015/1999. As a result, the CER will unwind as to 1/6th each year from accounting period ending 31 December 2016.

The Finance (No. 2) Act 2015 which was substantively enacted on 26 October 2015 reduced the main rate of corporation tax to 19% with effect from 1 April 2017 and 18% with effect from 1 April 2020.

The Finance Act 2016, which was substantively enacted on 6 September 2016, further reduced the corporation tax rate to 17% with effect from 1 April 2020.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

18. Provisions for other liabilities and charges

	2016			2015		
	Premium rebates £000	Levies £000	Total £000	Premium rebates £000	Levies £000	Total £000
At 1 January	5,025	-	5,025	144	-	144
Utilised during the year	(185)	(23,159)	(23,344)	1,757	(652)	1,105
- additional provisions	2,085	23,159	25,244	4,554	652	5,206
- over provision from prior years	(1,800)	-	(1,800)	(1,430)	-	(1,430)
At 31 December	5,125	-	5,125	5,025	-	5,025

All of the above provisions are expected to be utilised within one year of the reporting date.

(a) Levies

(i) Financial Services Compensation Scheme ("FSCS") Levy
This levy £1.2m (2015: £0.7m) 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"). In accordance with IFRIC 21, the FSCS Levy was accrued and paid during the year.

(ii) Flood Re Levy
In 2016 the Company entered the market wide Flood Re scheme to ensure at risk customers are able to obtain flood protection. This requires the Company to pay, based on its % of total market GWP, a levy of £22m in 2016 (2015 £nil).

(b) 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.

19. Accruals

	2016 £000	2015 £000
Accrued expenses	915	2,806
Total	915	2,806

All accruals are current liabilities.

20. Other financial liabilities

	2016 £000	2015 £000
Due to related parties	107,074	63,197
Insurance payables	18,281	6,916
Other payables	17,138	14,657
Other taxes payable	13,563	10,234
Total	156,056	95,004

All insurance and other payables are current liabilities.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

21. Borrowings

	2016 £000	2015 £000
Bank overdrafts	9,389	-
Total	9,389	-

All borrowings are repayable within one year.

22. Decrease in operating assets and liabilities

	2016 £000	2015 £000
Decrease in operating assets:		
Intangible insurance assets	3,484	(26,794)
Financial assets:		
Loans and receivables	24,754	41,060
Net decrease in operating assets	28,238	14,266
Increase in operating liabilities:		
Insurance contract liabilities (net)	(39,767)	74,505
Provisions for other liabilities and charges	100	4,881
Other financial liabilities and accruals	59,161	(21,397)
Net increase in operating liabilities	19,494	57,989
Net decrease in operating assets and liabilities	47,732	72,255

23. Dividends paid

	2016 £000	2015 £000
Total dividends paid on equity shares	65,000	-

The Board of Directors approved interim dividends payable to Lloyds Bank General Insurance Holdings Limited of £65.0m (£0.75 per share) during the year (2015: £nil).

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

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

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.

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

(2) <u>Key assumptions</u>

(a) Home

Significant perils and loss 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 home 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 aim of the OCR review for Creditor 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, 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. This covers both the reserve reflecting expected changes in estimates for reported claims only (incurred but not enough reported) and reserve to provide for claims in respect of events that may have occurred before the accounting date but has still to be reported to the insurer by that date (incurred but not yet reported).

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 no URR (2015: nil) in respect of the single premium creditor business was required. Due to the fact that the loss ratio for Creditor products is less than 100% URR is not required.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

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

(2) Key assumptions (continued)

(c) Claims development tables

The development of insurance liabilities is 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 liability amount appearing in the Balance Sheet. The accident year basis is considered the most appropriate for the business written by the Company.

Home - gross

Accident year	**2012 £000**	**2013 £000**	**2014 £000**	**2015 £000**	**2016 £000**	**Total £000**
Estimate of ultimate claims costs:						
- at end of accident year	174,854	175,471	145,391	205,166	224,067	-
- one year later	161,742	165,512	145,780	198,512	-	-
- two years later	156,610	150,355	146,396	-	-	-
- three years later	157,194	150,148	-	-	-	-
- four years later	157,080	-	-	-	-	-
Current estimate of cumulative claims	157,080	150,148	146,396	198,512	224,067	876,203
Cumulative payments to date	(154,638)	(146,272)	(142,248)	(183,388)	(138,024)	(764,570)
Liability recognised in the Balance Sheet	2,442	3,876	4,148	15,124	86,044	111,633
Liability in respect of prior years						5,484
Total gross liability included in the Balance Sheet						117,117

Home -net

Accident year	**2012 £000**	**2013 £000**	**2014 £000**	**2015 £000**	**2016 £000**	**Total £000**
Estimate of ultimate claims costs:						
- at end of accident year	174,854	175,471	145,391	205,166	224,067	-
- one year later	161,742	165,512	145,780	198,512	-	-
- two years later	156,610	150,355	146,396	-	-	-
- three years later	157,194	150,148	-	-	-	-
- four years later	157,080	-	-	-	-	-
Current estimate of cumulative claims	157,080	150,148	146,396	198,512	224,067	876,203
Cumulative payments to date	(154,638)	(146,272)	(142,248)	(183,388)	(138,024)	(764,570)
Liability recognised in the Balance Sheet	2,442	3,876	4,148	15,124	86,044	111,633
Liability in respect of prior years						5,276
Total net liability included in the Balance Sheet						116,909

As at the year ended 31 December 2016 the Company limited its exposure to loss within insurance operations through participation in reinsurance arrangements. The home portfolio is protected through a catastrophe excess of loss arrangement which operates across both LBG General Insurance legal entities. The reinsurance programme was renewed on 1 July 2016. Amounts recoverable from reinsurers were estimated in a manner consistent with the assumptions used for ascertaining the underlying policy benefits. The purpose of a home excess of loss catastrophe reinsurance programme is to protect against the adverse effects of large weather related events.

The gross liability of £117.1m and net liability of £116.9m shown in the above tables exclude £8.7m of unallocated claims handling expenses.

In order to improve the presentation of the Estimate of cumulative claims as at year end 2015 to give a more accurate reflection of development, Accident year 2015 has increased by £13.9m and Accident year 2014 has decreased by £3.5m.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

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

(2) Key assumptions (continued)

(c) Claims development tables (continued)

Creditor – gross and net

Accident year	2012 £000	2013 £000	2014 £000	2015 £000	2016 £000	Total £000
Estimate of ultimate claims costs:						
- at end of accident year	17,815	8,710	7,388	5,596	4,892	
- one year later	13,529	7,258	6,197	4,225		
- two years later	13,537	6,742	6,555			
- three years later	13,003	6,628				
- four years later	13,073					
Current estimate of cumulative claims	13,073	6,628	6,555	4,225	4,892	35,372
Cumulative payments to date	(13,037)	(6,577)	(6,466)	(3,817)	(2,641)	(32,537)
Liability recognised in the Balance Sheet	37	51	88	408	2,251	2,835
Liability in respect of prior years						62
Total liability included in the Balance Sheet						2,897

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

The liability of £2.9m shown in the above table excludes £0.6m of unallocated claims handling expenses.

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 £11.1m net of reinsurance (2015: £11.5m). Similarly, an increase of 10% in the number of all claims would result in the recognition of an additional cost of £12.0m net of reinsurance (2015: £12.3m). A 5% increase in the inflation rate of claims would result in the recognition of an additional cost of £5.5m net of reinsurance (2015: £5.8m).

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 home 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 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 (with appropriate Insurance focus) within the Company.

This enterprise-wide risk management framework for the identification, assessment, measurement and management of risk covers the full spectrum of risks the Company is exposed to, with risks categorised according to an approved LBG risk language. This covers the principal risks faced by the Company, including the exposures to market, insurance, credit, capital, liquidity, regulatory & legal, conduct, people, governance, operational and financial reporting risks. The performance of LBG, its continuing ability to write business and the strategic management of the business depend on its ability to manage these risks.

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.

Responsibility for setting and managing risk appetite and risk policy resides with the Board. Risks are managed in line with LBG and Insurance risk policies. The Board has delegated certain risk matters to the Insurance Risk Oversight Committee ("IROC") with operational implementation assigned to the Insurance Risk Committee.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

25. Risk management (continued)

(a) Governance framework (continued)

The risk management approach aims to ensure effective independent checking or "oversight" of key decisions by operating 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 is the second line of defence. Internal Audit, the third line of defence, provide independent assurance to the Insurance Audit Committee and the Board that risks are recognised, monitored and managed within acceptable parameters.

Policy owners, identified from appropriate areas of the LBG and Insurance business, are responsible for drafting risk policies, for ensuring that they remain up-to-date and for facilitating any changes. Policies are subject to at least an annual review. Limits are prescribed within which those responsible for the day to day management 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 a framework for the management of risk and approved a set of risk appetite statements that cover financial risks (earnings, capital, insurance, credit, market and liquidity), operational risks, people, conduct risks, regulatory & legal risks, financial reporting and governance risks. The risk appetite statements set limits for exposures to the key risks faced by the business. Risk appetite is reviewed at least annually by the Board. Executive owned Tier 2 and Tier 3 limits sit beneath Board owned risk appetite (Tier 1) and are managed and governed within the Insurance business.

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

(c) Financial risks

The Company is exposed to financial risk through its financial assets, financial liabilities, assets arising from reinsurance contracts and liabilities arising from insurance and investment contract liabilities. In particular, the key financial risk is that investment proceeds are not sufficient to fund the obligations arising from its insurance contracts.

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 analyses presented also represents management's assessment of a reasonably possible alternative in respect of each sensitivity, rather than worst case scenario positions.

(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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

25. Risk management (continued)

(c) Financial risks (continued)

(1) Market risk (continued)

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.

Below is an analysis of assets and liabilities at fair value through profit or loss and assets and liabilities for which a fair value is required to be disclosed, according to their fair value hierarchy (as defined in Note 1 (d)).

As at 31 December 2016		**Fair value hierarchy**		
	Level 1	**Level 2**	**Level 3**	**Total**
	£000	**£000**	**£000**	**£000**
Collective Investment Schemes – unlisted	243,685	-	-	243,685
Debt securities – listed	-	250,853	-	250,853
Debt securities – unlisted	-	-	29,614	29,614
Total assets	243,685	250,853	29,614	524,152

As at 31 December 2015		**Fair value hierarchy**		
	Level 1	**Level 2**	**Level 3**	**Total**
	£000	**£000**	**£000**	**£000**
Collective Investment Schemes – unlisted	240,975	-	-	240,975
Debt securities – listed	-	98,456	-	98,456
Debt securities –unlisted	-	-	67,431	67,431
Total assets	240,975	98,456	67,431	406,862

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 £0.8m (2015 £1.2m) or increase it by £0.8m (2015 £1.3m).

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).

	2016	**2015**
	£000	**£000**
Balance at 1 January	67,431	113,361
Net losses recognised within net fair value gains on financial assets held at fair value through profit or loss in the Statement of Comprehensive Income	(187)	(528)
Disposals	(37,630)	(45,402)
Balance at 31 December	29,614	67,431
Total unrealised gains for the period included in the Statement of Comprehensive Income for assets held at 31 December	252	1,671

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

25. Risk management (continued)

(c) Financial risks (continued)

(1) Market risks (continued)

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 2016 was £1.6m (2015: £1.4m).

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 arise 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.

Impact on profit after tax and equity at reporting date	2016 £m	2015 £m
100 basis points increase in yield curves	0.65	0.70
100 basis points decrease in yield curves	(0.65)	(0.70)

(2) Insurance risk

Insurance risk is defined as the risk of adverse developments in the timing, frequency and severity of claims for insured/underwritten events and in customer behaviour, leading to reductions or volatility in earnings and/or value.

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) Home

(a) Frequency and severity of claims

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

The Company has the right to re-price the risk on renewal and also has the ability to impose excesses. These contracts are underwritten by reference to the replacement value of the properties and contents insured.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

25. Risk management (continued)

(c) Financial risks (continued)

(2) Insurance risk (continued)

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 natural catastrophes to limit losses in any one year from both large single events and a number of events occurring over the year. The maximum loss for a single event up to £783.6m is £137.5m across Lloyds Banking Group General Insurance (2015: £660.8m, £126.2m). £100m of protection is provided which responds when the total cost for events greater than £2.0m exceeds £137.5m.

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

Home 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.

(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.

(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 no URR (2015: nil) in respect of the single premium creditor business was required. This was due to the fact that the loss ratio for Creditor products is less than 100%, hence URR is not required.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

25. Risk management (continued)

(c) Financial risks (continued)

(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 Committee ("IFC"). 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. Reinsurance is primarily used to reduce insurance risk. However, it is also sought for other reasons such as improving profitability, reducing capital requirements and obtaining technical support.

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. 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 2016

	Total £000	AAA £000	AA/A £000	B £000	Not Rated £000
Reinsurance assets	10,374	-	10,374	-	-
Loans and receivables	301,254	-	-	-	301,254
Debt Securities – listed	250,853	250,853	-	-	-
Debt Securities – unlisted	29,614	29,614	-	-	-
Collective investment schemes – unlisted	243,685	243,685	-	-	-
Cash and cash equivalents	143,683	135,732	7,951	-	-
Total	979,463	659,884	18,325	-	301,254

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

25. Risk management (continued)

(c) Financial risks (continued)

(3) Credit risk (continued)

Financial assets held at fair value through profit or loss:

As at 31 December 2015

	Total £000	AAA £000	AA/A £000	B £000	Not Rated £000
Reinsurance assets	8,047	-	8,047	-	-
Loans and Receivables	326,008	-	-	-	326,008
Debt securities - listed	98,456	98,456	-	-	-
Debt securities – unlisted	67,431	67,431	-	-	-
Collective investment schemes – unlisted	240,975	240,975	-	-	-
Cash and Cash equivalents	238,489	220,878	17,611	-	-
Total	979,406	627,740	25,658	-	326,008

Amounts classified as "not rated" within assets arising from reinsurance contracts held principally relate to amounts due from other Group companies which are not rated by Standard & Poor's or an equivalent rating agency.

(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 Undertakings for Collective Investment in Transferable Securities "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 2016 and 31 December 2015, 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 marketable equity and debt securities in line with the investment options offered to policyholders, it is unlikely that a material concentration of liquidity risk 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 Insurance Finance Committee ("IFC"), the Insurance Risk Committee ("IRC"), Insurance Shareholder Investment Management Committee ("ISIM") and Insurance Banking Liquidity Operations Committee ("BLOC").

(5) Financial soundness risk

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

(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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

25. Risk management (continued)

(c) Financial risks (continued)

(5) Financial soundness risk (continued)

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

Insurance 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.

Insurance 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.

In order to measure liquidity risk exposure the Company's liquidity is assessed in a stress scenario. Liquidity risk appetite considers two time periods; three month stressed outflow are required to be covered by primary liquid assets; and one year stressed outflow are required to be covered by primary and secondary liquid assets, after taking account of management actions. Primary liquid assets are gilts or cash, and secondary liquid assets are tradable non-primary assets.

Liquidity risk is managed in line with the Insurance Liquidity Risk Policy and the wider LBG Funding and Liquidity Policy.

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

25. Risk management (continued)

(c) Financial risks (continued)

(5) Financial soundness risk (continued)

(ii) Liquidity risk (continued)

As at 31 December 2016

	Total £000	Up to 3 months £000	3-12 months £000	1-2 years £000	More than 2 years £000
Short-term insurance contracts	131,552	59,092	45,287	13,993	13,180
Other financial liabilities, borrowings and accruals	166,360	166,360	-	-	-
Total	297,912	225,452	45,287	13,993	13,180

As at 31 December 2015

	Total £000	Up to 3 months £000	3-12 months £000	1-2 years £000	More than 2 years £000
Short-term insurance contracts	124,900	54,446	41,613	14,263	14,578
Other financial liabilities, borrowings and accruals	97,348	97,348	-	-	-
Total	222,248	151,794	41,613	14,263	14,578

Short-term insurance contracts include claims reported and loss adjustment expenses, claims incurred but not reported and unexpired risk reserve as disclosed in note 16.

(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 Prudential Regulatory Authority ("PRA") and the Financial Conduct Authority ("FCA"). The PRA specifies the minimum amount of regulatory capital that must be held by the Company.

The PRA rules, which incorporate all Solvency II requirements, specify the minimum amount of capital that must be held by the Company in addition to their insurance liabilities. Under the Solvency II rules, the Company must hold assets in excess of this minimum amount, which is derived from an economic capital assessment undertaken by the Company and the quality of capital held must also satisfy Solvency II tiering rules. This is reviewed on a quarterly basis by the PRA.

The Solvency II 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.

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

25. Risk management (continued)

(c) Financial risks (continued)

(5) Financial soundness risk (continued)

(iii) Capital risk (continued)

The capital management strategy is such that the 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 for the Company on a Solvency II basis. The current year information is an estimate of the final result:

	2016 £000	2015 £000
Regulatory capital held	447,712	427,968

All minimum regulatory requirements were met during the year.

(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 secondary categories of operational risk including the undernoted:

People risk
The risk of reductions in earnings and/or value through financial or reputational loss arising from the Company failing to lead, manage and enable colleagues to deliver to customers, shareholders and regulators.

Financial crime and fraud 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 bribery, and obligations related to money laundering, sanctions and counter terrorism.

Fraud risk covers the risk of acts intended to defraud, misappropriate property or circumvent the law.

Information security and physical security risk
Information 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 security of the Company's information and data. Physical security risk relates to the risk to the security of people and property.

Business interruption risk
Business interruption risk covers the risk, or instances of interruptions to business operations (including critical buildings, critical and core infrastructure and IT systems, suppliers and colleagues), as a consequence of external or internal events due to inadequate recovery strategies and/or continuity systems and controls.

Operational resilience risk
Operational resilience risk covers the risk or instances of interruptions to business operations (including critical buildings, critical and core infrastructure and IT systems, suppliers and colleagues), as a consequence of external or internal events due to insufficient resilience, inadequate recovery strategies and/or continuity systems and controls.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

25. Risk management (continued)

(d) Operational risks (continued)

Financial reporting process risk
Financial reporting process risk covers the risk that the Company suffers reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over financial reporting, failure to manage the associated risks of changes in taxation rates, law, ownership or corporate structure and the failure to disclose accurate and timely information.

Governance risk
The risk that the Company's organisational infrastructure fails to provide robust oversight of decision making and the control mechanisms to ensure strategies and management instructions are implemented effectively.

Change risk
Change risk comprises the risk of potential loss from key projects or programmes failing to deliver to requirements, budget or timescale, failing to implement change effectively or failing to realise desired benefits.

Sourcing and service provision risk
Sourcing risk covers the risk of reductions in earnings and/or value through financial or reputational loss from risks associated with activity related to the agreement and management of services provided by third parties including outsourcing.

Service provision risk covers the risks associated with provision of services to a third party and with the management of internal intra-group service arrangements.

IT Systems and Cyber risk

The risk of reductions in earnings and/or value through financial or reputational loss resulting from the failure to develop, deliver, maintain or protect against cyber attack effecting the company's IT solutions. The Directors have embedded a risk framework and monitor the effective operation of this across the Company.

(e) Regulatory and legal risk

Regulatory and legal risk is defined as the risk that the Company is exposed to fines, censure, legal or enforcement action, civil or criminal proceedings in the courts (or equivalent) and risk that the Company is unable to enforce its rights as anticipated.

Regulators aim to protect the rights of customers, ensuring firms satisfactorily manage their affairs for the benefit of customers and that they retain sufficient capital and liquidity. The Company has embedded a risk framework to closely monitor and manage its legal and regulatory risks, and maintains regular interaction with its regulators.

(f) Conduct risk

Conduct risk is defined as the risk of customer detriment or regulatory censure and/or a reduction in earnings/value, through financial or reputational loss, from inappropriate or poor customer treatment or business conduct.

The Company is focused on delivering fair customer outcomes, and has embedded a risk framework to effectively monitor and manage its conduct risks.

26. Contingencies and commitments

LBG provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to tax authorities. This includes open matters where Her Majesty's Revenue and Customs (HMRC) adopt a different interpretation and application of tax law which might lead to additional tax. LBG has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013 HMRC informed LBG that their interpretation of the UK rules, permitting the offset of such losses, denies the claim; if HMRC's position is found to be correct management estimate that this would result in an increase in current tax liabilities for the Company of approximately £20.7m (including interest). LBG does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

27. Related party transactions

(a) Ultimate parent and shareholding

The Company's immediate parent company is Lloyds Bank General Insurance Holdings Limited, a company registered in the United Kingdom.

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 financial statements of Lloyds Bank plc may be obtained from Insurance Secretariat, 69 Morrison Street, Edinburgh EH3 8YF.

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

(b) Transactions and balances with related parties

The Company's related parties include parents, subsidiary, fellow subsidiaries, pension schemes of the Company's ultimate parent company and the Company's key management personnel.

Transactions between the Company and other LBG companies

The Company has entered into transactions with related parties in the normal course of business during the year. Loans to related parties are made on normal arm's length commercial terms

	2016			
	Income during period £000	Expenses during period £000	Payable at period end £000	Receivable at period end £000
Relationship				
Parent	-	65,000	-	-
Other related parties	5,068	282,309	131,760	298,245

	2015			
	Income during period £000	Expenses during period £000	Payable at period end £000	Receivable at period end £000
Relationship				
Parent	-	-	6,480	6,417
Other related parties	4,510	262,928	62,737	200,273

The above balances are unsecured in nature and are expected to be settled in cash.

Parent undertaking transactions relate to all transactions and balances with parent companies, such transactions include cash and cash equivalent balances and Group relief for income tax.

Transactions with other related parties (which include Subsidiaries and other Insurance Intermediaries) are primarily in relation to Intra-Group trading and operating and employee expenses.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

27. Related-party transactions (continued)

Transactions and balances with related parties (continued)

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 Executive Directors. Key management personnel, as defined by IAS 24, are employed by a management entity, transactions with this entity are as follows:

	2016 £000	2015 £000
Key management compensation		
Salaries and other short-term employee benefits	367	380
Post-employment benefits	10	9
Share-based payments	106	191
Total	483	579

Included in short term employee benefits is the aggregate amount of emoluments paid to or receivable by directors in respect of qualifying services of £197k (2015: £228k).

There were no retirement benefits accrued to directors (2015: one director) under defined benefit pension schemes. Six directors (2015: six directors) are paying into a defined contribution scheme. The aggregate value of contributions paid to a pension scheme for qualifying services was £1k (2015: £4k)

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

The aggregate amount of money receivable and the net value of assets received/receivable under share based incentive schemes in respect of directors qualifying services was £77k (2015: £149k). During the year, three directors exercised share options (2015: two directors) and eight directors' received qualifying services shares under long term incentive schemes (2015: five directors).

In addition, during the year amounts of £nil (2015: £nil) became payable to the highest paid director in relation to their retirement from office.

Detail regarding the highest paid Director is as follows:

Detail regarding the highest paid director:

	2016 £000	2015 £000
Apportioned aggregate emoluments	85	116
Apportioned post employment benefits	1	-
Apportioned share based payments	50	53
Total	136	169

The highest paid director did exercise share options during the year. (2015: The highest paid director did not exercise share options during the year, but was granted shares in respect of qualifying service).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

28. 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 2016 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"	Replaces IAS 39 "Financial Instruments: Recognition and Measurement." Classification and Measurement IFRS 9 requires financial assets to be classified into one of three measurement categories, fair value through profit or loss, fair value through other comprehensive income or amortised cost. Financial assets will be measured at amortised cost if they are held within a business model the objective of which is to hold financial assets in order to collect contractual cash flows, and their contractual cash flows represent solely payments of principal and interest. Financial assets will be measured at fair value through other comprehensive income if they are held within a business model the objective of which is achieved by both collecting contractual cash flows and selling financial assets and their contractual cash flows represent solely payments of principal and interest. Financial assets not meeting either of these two business models; and all equity instruments (unless designated at inception to fair value through other comprehensive income); and all derivatives are measured at fair value through profit and loss. An entity may, at initial recognition, designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch. The Company has undertaken an assessment to determine the potential impact of changes in classification and measurement of financial assets. The adoption of IFRS 9 is unlikely to result in significant changes to existing asset measurement bases, however, the final impact will be dependent on the facts and circumstances that exist on 1 January 2018. IFRS 9 retains most of the existing requirements for financial liabilities. However, for financial liabilities designated at fair value through profit or loss, gains or losses attributable to changes in own credit risk may be presented in other comprehensive income. Impairment The IFRS 9 impairment model will be applicable to all financial assets at amortised cost, debt instruments measured at fair value through other comprehensive income, lease receivables, loan commitments and financial guarantees not measured at fair value through profit or loss. IFRS 9 replaces the existing 'incurred loss' impairment approach with an Expected Credit Loss ('ECL') model, resulting in earlier recognition of credit losses compared with IAS 39. Expected credit losses are the unbiased probability weighted average credit losses determined by evaluating a range of possible outcomes and future economic conditions.	Annual periods beginning on or after 1 January 2018

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

28 Future accounting developments (continued)

Pronouncement	Nature of change	IASB effective date
IFRS 9 "Financial Instruments" (continued)	The ECL model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk since initial recognition (stage 2). Stage 3 requires objective evidence that an asset is credit-impaired, which is similar to the guidance on incurred losses in IAS 39. The requirement to recognise lifetime ECL for loans which have experienced a significant increase in credit risk since origination, but which are not credit impaired, does not exist under IAS 39. The assessment of whether an asset is in stage 1 or 2 considers the relative change in the probability of default occurring over the expected life of the instrument, not the change in the amount of expected credit losses. This will involve setting quantitative tests combined with supplementary indicators such as credit risk classification. Reasonable and supportable forward looking information will also be used in determining the stage allocation. Any asset more than 30 days past due, but not credit impaired, will be classed as stage 2. Whilst the Company is still refining its methodology and completing the development of the models required to calculate the provision, it is not possible to provide a reliable estimate of the impact of adopting IFRS 9. However, IFRS 9 is not expected to have a significant financial impact on the financial results or position of the Company. Hedge Accounting The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach than IAS 39. The standard does not address macro hedge accounting, which is being considered in a separate project. There is an option to maintain the existing IAS 39 hedge accounting rules until the IASB completes its project on macro hedging. The Company currently expects to continue applying IAS 39 hedge accounting in accordance with this accounting policy choice.	Annual periods beginning on or after 1 January 2018
IFRS 15 "Revenue from Contracts with Customers" [1]	Replaces IAS 18 "Revenue" and IAS 11 "Construction Contracts". IFRS 15 establishes principles for reporting useful information about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised at an amount that reflects the consideration to which the entity expects to be entitled in exchange for goods and services. Financial instruments, leases and insurance contracts are out of scope and so this standard is not expected to have a significant impact on the financial results or position of the Company.	Annual periods beginning on or after 1 January 2018

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016

28 Future accounting developments (continued)

Pronouncement	Nature of change	IASB effective date
Minor amendments to other accounting standards [1]	During 2016, the IASB has issued amendments to IAS 7 Statement of Cash Flows (which require additional disclosure about an entity's financing activities) and IAS 12 Income Taxes (which clarify when a deferred tax asset should be recognised for unrealised losses) together with a number of other minor amendments to IFRSs. These revised requirements are not expected to have a significant impact on the Company.	Annual periods beginning on or after 1 January 2017 or 2018

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

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