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**LEGAL & GENERAL INSURANCE LIMITED**

**REPORT AND ACCOUNTS**

**2011**

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## **Legal & General Insurance Limited**

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#### **Registered office**

One Coleman Street  
London EC2R 5AA

Registered in England and Wales No 00423930

## Legal & General Insurance Limited Directors' Report

The directors submit their annual report together with the audited financial statements of Legal & General Insurance Limited for the year ended 31 December 2011

### Business review and principal activity

The Company is an insurance company authorised in the UK, the principal activity of which is the transaction of general insurance business in the personal sector marketplace, specifically relating to risk covers for household and mortgage payment protection insurance

The Company continues to pursue a strategy focused on the housing marketplace, including leveraging the distribution relationships from the wider Legal & General proposition focused on the housing purchase event. During the year we have enhanced our direct distribution capability and have continued to focus on improving underlying operational efficiency, in particular around claims management and improved underwriting standards. This coupled with investment in developing the product proposition sees the business well placed to meet the demands of the market and deliver growth as and when the economic cycle turns.

Market conditions remained challenging with business volumes impacted by low housing market transactions and the general uncertainty in economic conditions. However we achieved 9% top line premium growth and believe there is still significant opportunity to increase premium income even in the current climate.

### Result for the year and dividend

The results of the Company shows a pre-tax profit of £31.8 million (2010 loss £4.4 million), details of which are set out on page 7. The result reflects generally favourable weather experience during the year as well as the ongoing benefit of underwriting and claims management initiatives. The directors do not recommend the payment of a dividend (2010: £nil).

### Key performance indicators

In addition to the pre-tax performance noted above other key measures monitored by the Board are as follows:

	2011	2010
Year end shareholders funds	£129m	£105m
Gross written premium	£305m	£281m
Profit/(Loss) before tax	£31.8m	(£4.4m)
Combined operating ratio	92%	109%

The combined operating ratio is

$$\left[ \frac{\text{Net incurred claims}}{\text{Net Earned premiums}} + \frac{\text{Expenses + Net commission}}{\text{Net written premiums}} \right] \times 100$$

### Principal risks and uncertainties

The Company's business involves the acceptance and management of risk. The process of risk acceptance and risk management is managed through a risk framework, comprising formal committees, risk assessment processes and review functions with formal updates to the Board. A full review of risks is discussed in Note 29.

The framework provides assurance that risks are being appropriately identified and managed and that an independent assessment of risks is being performed. The principal risks and uncertainties facing the Company are noted below.

### Market and Economic Conditions

Competitor activity and changes in customer buying patterns would impact the achievement of sales targets. A number of Legal & General Insurance Limited (LGI)'s business channels have close links to the housing market. Uncertainty in this market would restrict sales opportunities and adversely impact profitability. The LGI strategy focused on household insurance means LGI has limited product diversification, and the payment protection product would be impacted by any downturn in economic conditions.

The Company is also exposed to the impact of adverse economic conditions on its investment portfolio. The Company's investment portfolio consists of fixed income and money market instruments, which are affected by movements in interest rates and credit spreads.

## **Legal & General Insurance Limited Directors' Report**

### **Weather Catastrophe Events**

Weather related risk is the largest area of risk faced by an insurer writing household business. The risk of adverse claims experience is fully assessed and reflected in the Company's capital requirement, and reinsurance is in place to protect against a 1 in 200 year event, but a severe storm or series of weather events (including prolonged dry weather leading to subsidence) would adversely impact the profitability of the business. If the event was coupled with the default of a re-insurer this could significantly impact the capital available to the Company.

### **Confidence in the Financial Services Sector and Specifically LGI**

Events in the financial services sector outside the control of the Company and the Group may impact earnings and profitability. Historically such events have included:

- Failings by competitors
- Actions by regulators within the industry
- Adverse performance of investment markets
- Adverse media coverage

### **Resources**

The Legal & General Group has market-leading expertise in a number of the markets in which it operates. The Company as part of a larger Group, actively focuses on retaining the best personnel and ensuring that key dependencies do not arise through employee training and development programmes, remuneration strategies and succession planning. However, the loss of key personnel may impact earnings in the short term.

### **Regulation and Legislation**

There are a number of aspects to the way in which legislation and regulation impacts the Company's business:

- Government fiscal policy
- Regulation of product design, marketing, sales and administration
- Prudential capital requirements
- The introduction of Solvency II and its impact on capital requirements and business risk management

The Company's activities and strategies are always based upon prevailing legislation and regulation. However, significant changes in legislation, and differing interpretation and application of regulation over time, may have a detrimental effect on the Company's strategy and profitability. Additionally, there is an increasing international dimension and volume of regulatory and legislative change impacting the financial services sector.

### **Outsourcing and Key Supplier Risk**

There are some core Company functions that are outsourced, and a reliance on suppliers to satisfy buildings and contents claims, which involves the Company in the management of a number of customer related third party relationships. Despite the rigorous selection process including supplier financial evaluations and the preparation of contingency plans to maintain service the financial failure of a third party or provision of inadequate service would impact the reputation and regulatory compliance of the Company.

### **Future developments**

Going forward the Company will continue to evolve its strategy around the housing marketplace, focusing on the development of sustainable profitable relationships and strong management of loss ratios through improved underwriting and claims management techniques.

### **Creditors**

The Legal & General Group Plc agrees terms and conditions for its business transactions with suppliers. Payment is made on these terms provided the supplier meets its obligations. The Company has no trade creditors. As at 31 December 2011, the average number of days of payments outstanding for the Legal & General Group of companies was 36 days (2010: 34 days).

### **Financial Risk Management**

Legal & General companies use financial instruments to manage certain financial risks. The Company's exposure to financial risk through its financial assets and liabilities is not considered material to the assessment of the Company's assets, liabilities, financial position and the profit and loss of the Company.

## **Legal & General Insurance Limited Directors' Report**

### **Directorate**

The directors of the Company who served during the year, together with their dates of appointment and resignation, where appropriate, are shown below

J B Pollock (Chairman)  
M J Cooper (resigned 21 November 2011)  
D A Finch (appointed on 15 February 2011)  
P J Graham (resigned on 27 January 2011)  
S P Harry (appointed on 21 February 2011)  
G P Howard (resigned on 22 February 2011)  
M A Lawler  
G L Pickering (resigned on 22 February 2011)  
A M Webb (resigned 13 December 2011)

### **Secretary**

E Latzelsberger resigned as company secretary on 21 April 2011  
Legal & General Co Sec Limited was appointed as company secretary on 21 April 2011

### **Directors' Indemnities and Insurance**

As permitted by the Articles of Association, the Directors have the benefit of an indemnity which is a qualifying third party indemnity provision as defined by Section 234 of the Companies Act 2006. The indemnity was in force throughout the last financial year and is currently in force. The ultimate parent Company, Legal & General Group Plc, maintains an appropriate level of Directors' and Officers' liability insurance which is reviewed annually.

### **Auditors**

The Company has appointed PricewaterhouseCoopers LLP as auditors.  
There is no requirement under the Companies Act or the Company's articles of association to hold an Annual General Meeting or lay the Company's Report and Accounts before the shareholders. The Company has also elected to dispense with the need to appoint auditors annually.

## **Legal & General Insurance Limited**

### **Directors' Report**

#### **Statement of Directors' Responsibilities**

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

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

In preparing those financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates which are reasonable and prudent,
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements. In preparing these financial statements, the directors have also elected to comply with IFRSs, issued by the International Accounting Standard Board (IASB),
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping proper accounting records that are sufficient to show and explain the Company's transactions and disclose with 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 who held office at the date of approval of this directors' report confirms that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware and each of the directors have taken all reasonable steps that they ought to have taken as directors to ascertain any relevant audit information and to establish that the Company's auditors are aware of such information. This confirmation is given in accordance with section 418(2) of the Companies Act 2006.

By Order of the Board



D.A. Finch  
Director  
5 March 2012

## **Legal & General Insurance Limited**

### **Report of the Independent Auditors to the Members of Legal & General Insurance Limited**

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

#### **Respective responsibilities of directors and auditors**

As explained more fully in the Directors' Responsibilities Statement set out on page 5, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

#### **Scope of the audit of the financial statements**

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

#### **Opinion on financial statements**

In our opinion, the financial statements:

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

#### **Opinion on other matters prescribed by the Companies Act 2006**

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

#### **Matters on which we are required to report by exception**

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

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



Barnabas Wanstall (Senior Statutory Auditor)  
For and behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Registered Auditors  
London  
7 March 2012

# **Legal & General Insurance Limited** **Statement of Comprehensive Income**

For the year ended 31 December 2011

	Notes	2011 £'000	2010 £'000
<b>Revenue</b>			
Gross written premiums		304,752	281,038
Outward reinsurance premiums		(18,250)	(16,360)
Net change in provision for unearned premiums		(17,189)	(15,268)
<b>Net premiums earned</b>		269,313	249,410
Investment return - on financial investments at fair value through profit or loss	4	14,419	25,289
<b>Total revenue</b>		283,732	274,699
<b>Expenses</b>			
Claims and change in insurance liabilities		145,401	178,278
Reinsurance recoveries		(357)	(1,256)
<b>Net claims and change in insurance liabilities</b>	5	145,044	177,022
Acquisition costs	6	95,389	89,441
Finance costs	7	32	26
Other expenses	10	11,509	12,612
<b>Total expenses</b>		251,974	279,101
<b>Profit/(loss) before income tax</b>		31,758	(4,402)
Total income tax (expense)/credit	11	(8,014)	1,205
<b>Total comprehensive income attributable to equity holders of the Company</b>		23,744	(3,197)

The notes on pages 11 to 33 are an integral part of the financial statements



# Legal & General Insurance Limited

## Statement of Financial Position

As at 31 December 2011

	Notes	2011 £'000	2010 £'000	1 Jan 2010 £'000
<b>Assets</b>				
Investments in subsidiaries	14	2,608	2,608	2,608
Plant and equipment	13	56	114	182
Financial investments	15	291,103	285,833	245,731
Reinsurers' share of contract liabilities	19	8,814	8,207	10,768
Deferred acquisition costs	16	51,859	44,679	39,291
Income tax recoverable	11	-	3,449	-
Receivables arising out of direct insurance operations - policyholders	17	59,701	58,154	64,244
- intermediaries	17	20,615	18,588	14,648
Receivables arising out of reinsurance operations	17	-	-	1,554
Other receivables	17	-	46	34
Cash and cash equivalents	18	19,293	13,331	40,341
<b>Total assets</b>		<b>454,049</b>	<b>435,009</b>	<b>419,401</b>
<b>Equity</b>				
Share capital	24	3,500	3,500	3,500
Share premium		96,053	96,053	96,053
Retained earnings	25	29,599	5,855	9,052
<b>Shareholders' equity</b>		<b>129,152</b>	<b>105,408</b>	<b>108,605</b>
<b>Liabilities</b>				
Non-participating insurance contracts	19	244,348	260,507	228,920
Deferred tax liabilities	12	6,718	4,852	2,680
Income tax liabilities	11	6,077	-	3,258
Trade payables	21	24,022	21,453	21,920
Other payables	22	43,732	42,789	54,018
<b>Total liabilities</b>		<b>324,897</b>	<b>329,601</b>	<b>310,796</b>
<b>Total equity and liabilities</b>		<b>454,049</b>	<b>435,009</b>	<b>419,401</b>

The notes on pages 11 to 33 form an integral part of these financial statements

The financial statements on pages 7 to 33 were approved by the directors on 5 March 2012 and were signed on their behalf by



**D A Finch**  
Director

**Legal & General Insurance Limited****Cash flow statement**

As at 31 December 2011

	2011 £'000	2010 £'000
<b>Cash flows from operating activities</b>		
Profit/(loss) for the year	23,744	(3,197)
<b>Adjustments for non-cash movements in net profit/(loss) for the year</b>		
Realised and unrealised losses/(gains) on financial investments	969	(10,465)
Investment income	(15,388)	(14,828)
Other adjustments	79	87
<b>Net (increase)/decrease in operational assets</b>		
Investments designated as held for trading or fair value through profit or loss	(6,525)	(27,762)
Other assets	(7,575)	(4,459)
<b>Net increase/(decrease) in operational liabilities</b>		
Insurance contracts	(16,159)	31,587
Other liabilities	11,450	(12,782)
<b>Cash used in operations</b>	(9,405)	(41,819)
Interest received	15,388	14,828
<b>Net cash flows from operating activities</b>	5,983	(26,991)
<b>Cash flows from investing activities</b>		
Net acquisition of plant and equipment	(21)	(19)
<b>Net cash flows from investing activities</b>	(21)	(19)
<b>Net increase in cash and cash equivalents</b>	5,962	(27,010)
Cash and cash equivalents at 1 January	13,331	40,341
<b>Cash and cash equivalents at 31 December</b>	19,293	13,331

**Legal & General Insurance Limited****Statement of Changes in Equity**

As at 31 December 2011

	Ordinary share capital £'000	Share premium £'000	Retained earnings £'000	Total £'000
Balance at 1 January 2010	3,500	96,053	9,052	108,605
Total comprehensive loss for the year	-	-	(3,197)	(3,197)
Balance at 31 December 2010	3,500	96,053	5,855	105,408

	Ordinary share capital £'000	Share premium £'000	Retained earnings £'000	Total £'000
Balance at 1 January 2011	3,500	96,053	5,855	105,408
Total comprehensive income for the year	-	-	23,744	23,744
Balance at 31 December 2011	3,500	96,053	29,599	129,152

The notes on pages 11 to 33 are an integral part of the financial statements

## **Legal & General Insurance Limited**

### **Notes to the Financial Statements**

#### **1 Accounting Policies**

##### **a) Basis of Preparation**

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB) as adopted by the European Union, and with those parts of the UK Companies Act 2006 applicable to companies reporting under IFRS. The Company's financial statements also comply with IFRS and International Financial Reporting Interpretations Committee (IFRIC) interpretations as issued by the IASB. These are the Company's first financial statements prepared in accordance with IFRS and IFRS 1 has been applied. An explanation of how the transition to IFRS has affected the reported financial position is explained in Note 2. The financial statements have been prepared under the historical cost convention, and financial assets at fair value through profit and loss. The Company is exempt from preparing consolidated financial statements by virtue of the Companies Act 2006, as its ultimate parent Company prepares publicly available consolidated financial statements that are deemed to satisfy the equivalence requirement of section 401 of the Companies Act 2006.

##### **b) Use of estimates**

The preparation of the financial statements includes the use of estimates and assumptions which affect items reported in the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity, the Cash Flow Statement and the disclosure of contingent assets and liabilities at the date of the financial statements. Although these estimates are based on management's best knowledge of current circumstances and future events and actions, actual results may differ from those estimates, possibly significantly. This is particularly relevant to the following:

##### **IBNR**

The use of claims incurred but not reported (IBNR) estimates are described in section c below.

##### **Tax balances**

The current tax expense is based on the taxable profits for the year, after any adjustments in respect of prior years. The judgement made, and uncertainties considered, in arriving at tax balances in the financial statements are discussed in Notes 11 and 12.

##### **c) General Insurance**

Results of general insurance business are determined after taking account of unearned premiums, outstanding claims and unexpired risks using the annual basis of accounting.

Premiums are accounted for in the period in which the risk commences. Estimates are included for premiums not notified by the year end. For all these contracts, premiums are recognised as revenue (earned premiums) proportionally over the period of coverage. The portion of premium received on in-force contracts that relates to unexpired risks at the balance sheet date is reported as the provision for unearned premium. Premiums are shown before deduction of commission. Outwards reinsurance premiums are accounted for in the same accounting period as the premiums for the related direct business being reinsured.

Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date, calculated on a time-apportioned basis. A proportion of commission and other acquisition expenses relating to unearned premiums are carried forward as deferred acquisition expenses or, with regard to reinsurance outwards, as deferred income. Deferred acquisition expenses are deferred over the period in which the related premiums are earned. Commissions and other acquisition costs that vary with and are related to securing new contracts and renewing existing contracts are capitalised as an intangible asset (DAC). All other costs are recognised as expenses when incurred. The DAC is subsequently amortised over the terms of the policies as premium is earned.

Claims incurred comprise claims and related expenses paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported and related expenses, together with any other adjustments to claims from previous years.

## **Legal & General Insurance Limited**

### **Notes to the Financial Statements**

#### **1 Accounting Policies (continued)**

##### **c) General Insurance (continued)**

Provision is made at the year-end for the estimated cost of claims and related insurance recoveries incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the Company. The estimated cost of claims includes expenses to be incurred in settling claims and a deduction for the expected value of salvage and other recoveries. The company takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

The estimation of claims incurred but not reported (IBNR) is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the Company, where more information about the claim event is generally available. Classes of business where the IBNR proportion of the total reserve is high will typically display greater variations between initial estimates and final outcomes because of the greater degree of difficulty in estimating these reserves. In calculating the estimated cost of IBNR and notified unpaid claims, the company uses a variety of estimation techniques, generally based upon statistical analyses of historic experience, which assumes that the development pattern of the current claims will be consistent with past experience. Allowance is made, however for changes or uncertainties which may create distortions in the underlying statistics or which may cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims.

An unexpired risk provision is made for any overall excess of expected claims and deferred acquisition costs over unearned premiums and after taking account of investment return.

##### **d) Reinsurance**

The Company cedes insurance premiums and risk in the normal course of business in order to limit the potential for losses and to provide financing. Outward reinsurance premiums are accounted for in the same accounting period as the related premiums for the direct or inward reinsurance business being reinsured. Reinsurance assets include balances due from reinsurers for paid and unpaid losses and loss adjustment expenses, ceded unearned premiums and ceded future life policy benefits. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Reinsurance is recorded as an asset in the balance sheet unless a right of offset exists, in which case the associated liabilities are reduced commensurately.

##### **e) Investments in subsidiaries**

Shares in subsidiary undertakings are stated at cost less impairment. The Company reviews the carrying value of its subsidiaries at each balance sheet date where there has been an indication that impairment has occurred. If the carrying value of a subsidiary undertaking or fixed asset is impaired, the carrying value is reduced through a charge to the income statement.

##### **f) Financial Investments**

The Company classifies its financial investments on initial recognition as held for trading (HFT), designated at fair value through profit or loss (FVTPL), or loans and receivables. Initial recognition of financial investments is on the trade date.

Certain financial investments held by the Company are designated as FVTPL as their performance is evaluated on a total return basis, consistent with asset performance reporting to the Group Investment and Market Risk Committee and the Company's investment strategy. Assets designated as FVTPL include debt securities which would otherwise have been classified as AFS under IAS 39, 'Financial instruments: recognition and measurement'. Assets backing participating and non-participating policyholder liabilities are designated as FVTPL.

The fair values of quoted financial investments are based on current bid prices. If the market for a financial investment is not active, the Company establishes fair value by using valuation techniques such as recent arm's length transactions, consensus market pricing, reference to similar listed investments, discounted cash flow models or option pricing models.

Financial investments classified as HFT and FVTPL are measured at fair value with gains and losses reflected in the income statement. Transaction costs are expensed as incurred.

## **Legal & General Insurance Limited**

### **Notes to the Financial Statements**

#### **1 Accounting Policies (continued)**

##### **f) Financial Investments (continued)**

Loans and receivables are initially measured at fair value plus acquisition costs, and subsequently measured at amortised cost using the effective interest method

##### **g) Investment Return**

The reporting of investment return comprises investment income, unrealised gains and losses from financial investments held at FVTPL and realised gains and losses from all financial assets

Investment income includes dividends and interest. Dividends are accrued on an ex-dividend basis. Interest is included on an accruals basis. Interest income for financial assets which are not classified as FVTPL is recognised using the effective interest method

##### **h) Deferred tax**

The charge for taxation is based on the result for the year adjusted for disallowable items. Deferred taxation is provided in full on all timing differences at the rate at which it is expected that the tax liability or benefit will arise. Deferred tax assets are recognised to the extent that it is more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted

##### **i) Preference shares**

Preference shares meeting the definition of a financial liability under the provision of IAS 32, "Financial Instruments disclosure and presentation," are classified within Creditors and the associated dividends are classified as interest expense

##### **j) Dividend recognition**

Final dividends are accrued when approved and interim dividends are recognised when paid

##### **k) Cash and cash equivalents**

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less and bank overdrafts

##### **l) Plant and equipment**

The initial cost of an item of plant or equipment is capitalised where it is probable that the future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The cost is then depreciated on a straight line basis over the item's estimated useful working life over 3 to 4 years

##### **m) 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. Where any Group company purchases the Company's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity attributable to the Company's equity holders. Where such shares are subsequently sold, reissued or otherwise disposed of, any consideration received is included in equity attributable to the Company's equity holders, net of any directly attributable incremental transaction costs and the related income tax effects

##### **n) Standards, Interpretations and amendments to published standards that are not yet effective**

Certain new standards, amendments and interpretations to existing standards have been published which are mandatory for the Company's accounting periods beginning on or after 1 January 2012 or later periods but which the Company has not adopted early, as follows

- (i) Amendment to IFRS 9, "Financial Instruments" on classification and measurement, issued in November 2009 (effective for annual periods commencing on or after 1 January 2015). This is the first part of a new standard on classification and measurement of financial assets that will replace IAS 39. IFRS 9 has two measurement categories: amortised cost and fair value. All equity instruments are measured at fair value. A debt instrument is at amortised cost only if the entity is holding it to collect contractual cash flows and the cash flows represent principal and interest; otherwise it must be measured at fair value through profit or loss. Further amendments to IFRS 9, dealing with financial liabilities, were published in October 2010. These include amortised cost accounting for most financial liabilities, with bifurcation of embedded derivatives

## **Legal & General Insurance Limited**

### **Notes to the Financial Statements**

#### **1 Accounting Policies (continued)**

##### **n) Standards, interpretations and amendments to published standards that are not yet effective (continued)**

The main impact of these is that in cases where the fair value option is taken for most financial liabilities the part of a fair value change due to an entity's own credit risk is now recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The Company does not intend to early adopt this standard.

##### **o) First time adoption of International Financial Reporting Standards (IFRS)**

The Company is required to determine its IFRS accounting policies and apply them retrospectively to establish its opening balance sheet under IFRS. However, IFRS 1 'First-time adoption of International Financial Reporting Standards' allows a number of exceptions and exemptions on adoption of IFRS for the first time. The date of transition for the Company is 1 January 2011, as required by IFRS. The disclosure required by IFRS 1 concerning the transition from UK GAAP to IFRS is given in Note 2.

The Company has taken advantage of the following exception as permitted by IFRS 1:

##### **Investments in subsidiaries, jointly controlled entities and associates**

Deemed cost for those investments in subsidiaries, jointly controlled entities and associates at the date of transition to IFRS is taken to be the previous GAAP carrying amount at that date.

#### **2 First time adoption of IFRS**

The UK GAAP balance sheet has been presented in a format consistent with International Financial Reporting Standards (IFRS). No changes have been made to the previously reported numbers for UK GAAP and the analyses of the adjustments are based on UK GAAP as at 31 December 2010.

##### **a) Claims equalisation provision**

Under UK GAAP an equalisation provision is recognised in the individual accounts of general insurance companies to reduce the volatility in results arising from exceptional levels of claims in certain classes of business. Under IFRS, such provisions are not permitted as no liability exists at the balance sheet date. Elimination of the claims equalisation provision results in an increase in equity holders' capital of £15,889,000 at 31 December 2010 (1 January 2010: £10,389,000), and an increase of £5,499,000 to profit after tax for the year ended 31 December 2010.

**Legal & General Insurance Limited**  
**Notes to the Financial Statements**

**2 First time adoption of IFRS (continued)**

**(i) Reconciliation of Statement of Comprehensive Income for the year ended 31 December 2010**

	Profit/ (loss) before tax £'000	(Loss) after tax £'000
<b>As reported under UK GAAP</b>	(11,739)	(8,698)
Claims equalisation provision	7,337	5,501
<b>As reported under IFRS</b>	(4,402)	(3,197)
<b>Attributed to equity holders of the company</b>		(3,197)

**(ii) Reconciliation of Statement of Financial Position as at 31 December 2010**

	As reported UK GAAP £'000	Adjustments Restated £'000	IFRS Restated £'000
<b>Assets</b>			
Current tax assets	3,449	-	3,449
<b>Equity and liabilities</b>			
Deferred tax (assets)/liabilities	(1,025)	5,877	4,852
Equalisation provision	21,766	(21,766)	-
Equity holders' capital	89,518	15,890	105,408

**(iii) Reconciliation of Statement of Financial Position as at 1 January 2010**

	As reported UK GAAP £'000	Adjustments Restated £'000	IFRS Restated £'000
<b>Equity and liabilities</b>			
Deferred tax (assets)/liabilities	(1,361)	4,040	2,679
Current tax liabilities	3,258	-	3,258
Equalisation provision	14,429	(14,429)	-
Equity holders' capital	98,216	10,389	108,605



## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 3 Profit/loss on ordinary activities before tax

	2011 £'000	2010 £'000
Profit/(loss) on ordinary activities before tax is stated after charging		
Depreciation of tangible assets	79	87
Auditors remuneration (see below for further analysis)	346	189
	<u>425</u>	<u>276</u>
During the year fees were paid to the Company auditor for the following services		
<b>Audit Services</b>		
Fees payable to the Company auditor for the audit of the Company	139	128
<b>Non Audit Services</b>		
Fees payable to the Company auditor for other services		
- Other services pursuant to legislation	63	61
- All other services	144	-
<b>Total</b>	<u>346</u>	<u>189</u>

No gains or losses were recognised on buying reinsurance

#### 4 Investment return

	2011 £'000	2010 £'000
Investment income	15,388	14,823
Unrealised gains/(losses)	3,815	13,166
Realised gains/(losses)	(4,784)	(2,700)
	<u>14,419</u>	<u>25,289</u>

All of the investment return arose on financial investments designated as fair value through profit or loss

#### 5 Net claims and change in insurance liabilities

	2011 £'000	2010 £'000
Claims paid		
- gross	179,457	161,040
- reinsurance recoveries	(458)	(2,898)
	<u>178,999</u>	<u>158,142</u>
Change in insurance liabilities		
- gross	(34,056)	17,238
- reinsurance recoveries	101	1,642
Net claims and change in insurance liabilities	<u>145,044</u>	<u>177,022</u>

#### 6 Acquisition costs

	2011 £'000	2010 £'000
Acquisition costs	102,568	94,829
Change in deferred acquisition costs	(7,179)	(5,388)
	<u>95,389</u>	<u>89,441</u>

## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 7 Finance costs

	2011 £'000	2010 £'000
Interest payable to group undertakings	7	5
Preference share dividends	25	21
	<u>32</u>	<u>26</u>

#### 8 Employee information

The company has no direct employees since they are employed by a fellow subsidiary of Legal & General Group Plc. As a result the Company makes no direct contributions towards retirement benefits (2010: £nil)

#### 9 Directors' emoluments

These figures represent that portion of the directors' emoluments that are estimated to relate to their services to the Company

	2011 £'000	2010 £'000
In respect of services as directors		
Aggregate emoluments	1,052	1,467
Aggregate money purchase contributions	<u>94</u>	<u>177</u>

No fees were paid by the Company to the directors

The emoluments received by the directors have been settled by a fellow group company, Legal & General Resources Limited, and included within the recharge made to the Company

	2011 £'000	2010 £'000
Highest paid director		
Emoluments	340	402
Money purchase contributions	<u>35</u>	<u>43</u>

Compensation for loss of office totalling £237,000 was paid to three directors

#### 10 Other expenses

	2011 £'000	2010 £'000
Administrative expenses	12,608	14,501
Reinsurance commissions and profit participations	(1,540)	(2,305)
Investment management expenses	<u>441</u>	<u>416</u>
	<u>11,509</u>	<u>12,612</u>

#### 11 Tax (credit)/charge

The tax shown in the income statement comprises current and deferred tax

##### Current Tax

Current tax is based on the taxable profits for the year, adjusted for disallowed for non-taxable items, and any adjustments to tax payable in respect of previous periods. Current tax is recognised in the income statement unless it relates to items which are recognised in other comprehensive income.

##### Deferred Tax

Deferred tax is calculated on differences between the accounting value of assets and liabilities and their respective tax values. Deferred tax is also recognised in respect of unused tax losses to the extent it is probable that future taxable profits will arise against which the losses can be utilised. Deferred tax is charged or credited to the income statement, except when it relates to items charged or credited directly to equity.

# **Legal & General Insurance Limited** **Notes to the Financial Statements**

## **11 Tax charge/(credit) (continued)**

### **Tax Rates**

Following the 2010 Budget announcement, the rate of corporation tax is expected to reduce progressively to 23% by 1 April 2014. To calculate the current tax on profits, the rate of tax used is 26.5% (2010: 28%), which is the average rate of corporation tax applicable for the year.

The rate of tax used for the calculation of deferred tax is 25% (2010: 27%), which is the rate of corporation tax that is expected to apply when the differences as mentioned above reverse. This rate will apply from 1st April 2012 (2010: 1st April 2011) onwards.

	2011 £'000	2010 £'000
<u>UK Corporation tax at 26.5% (2010: 28%)</u>		
- current tax for the year	6,094	(3,507)
- adjustments in respect of prior periods	54	130
Total current tax	6,148	(3,377)
<u>Deferred tax</u>		
- origination and reversal of timing differences	1,866	2,172
Tax on profit/(loss) on ordinary activities	8,014	(1,205)

### Factors affecting current tax charge for the period

The tax assessed for the period is lower than the standard rate of corporation tax in the UK (26.5%) (2010: 28%).

The differences are explained below:

	2011 £'000	2010 £'000
Profit/(Loss) on ordinary activities before tax	31,758	(4,382)
Corporation tax at 26.5%/28%	8,416	(1,227)
Effects of:		
Expenses not deductible for tax purposes	-	45
Adjustments in respect of prior periods	85	157
Income not subject to tax, such as dividends	6	-
Reduction in UK corporate tax rate to 25% (2010: 26%)	(493)	(180)
Current tax charge for period	8,014	(1,205)

### **Current tax**

	2011 £'000	2010 £'000
Tax due within 12 months	-	3,449
Tax due after 12 months	-	-
Current tax recoverable	-	3,449

	2011 £'000	2010 £'000
Tax due within 12 months	6,077	-
Tax due after 12 months	-	-
Current tax liabilities	6,077	-

## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 12 Deferred Tax

Deferred tax assets and (liabilities) have been recognised/(provided) for the following types of temporary differences and unused tax losses. The recognition of tax losses has been based on management projections to support the availability of taxable profits to absorb the losses in future years. Deferred tax assets and (liabilities) have been offset to the extent it is permissible under the accounting standard. The net movement in deferred tax assets and liabilities during the year is as follows:

##### Deferred tax (liabilities)

	Net tax liability as at 1 January 2011 £'000	Tax credited/(charged) to income statement £'000	Net tax liability as at 31 December 2011 £'000
Excess of dep'n over capital allowances	679	(186)	493
General provision	346	(112)	234
Claims equalisation reserve	(5,877)	(1,568)	(7,445)
Deferred tax liabilities	<u>(4,852)</u>	<u>(1,866)</u>	<u>(6,718)</u>

	Net tax liability as at 1 January 2010 £'000	Tax credited/(charged) to income statement £'000	Net tax liability as at 31 December 2010 £'000
Excess of dep'n over capital allowances	850	(172)	679
General provision	510	(164)	346
Claims equalisation reserve	(4,040)	(1,837)	(5,877)
Deferred tax liabilities	<u>(2,680)</u>	<u>(2,173)</u>	<u>(4,852)</u>

#### 13 Plant and equipment

	2011 £'000	2010 £'000	2009 £'000
<b>Cost</b>			
Balance at beginning of year	1,322	1,303	1,243
Additions	21	19	130
Disposals	-	-	(70)
Balance at end of year	<u>1,343</u>	<u>1,322</u>	<u>1,303</u>
<b>Depreciation</b>			
Balance at beginning of year	1,208	1,121	1,002
Charge for the year	79	87	189
Disposals	-	-	(70)
Balance at end of year	<u>1,287</u>	<u>1,208</u>	<u>1,121</u>
<b>Closing net book value</b>	<u>56</u>	<u>114</u>	<u>182</u>
<b>Opening net book value</b>	<u>114</u>	<u>182</u>	<u>241</u>

## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 14 Investments in subsidiaries

	2011	2010	1 Jan 2010
	£'000	£'000	£'000
Shares in group undertakings	2,608	2,608	2,608

The subsidiaries of Legal & General Insurance Limited are listed below

Held directly by the business	Nature of business	Incorporated in
Southgate Associates Limited	Dormant company	England & Wales
Legal & General GI Computer Services Limited	Dormant company	England & Wales
Legal & General Healthcare Limited	Dormant company	England & Wales
<b>Held indirectly through subsidiary undertakings</b>		
Glanfield Securities Limited	Investment company	England & Wales
Legal & General Investment Trust Limited	Investment company	England & Wales
Bridge End Computers Limited	Dormant company	England & Wales

All subsidiaries are 100% owned and have a 31 December financial year end. All subsidiaries are in the process of being liquidated with completion expected during 2012.

#### 15 Financial investments

	2011	2010	1 Jan 2010
	£'000	£'000	£'000
Debt securities and other fixed income securities	284,641	279,080	240,853
Accrued interest	6,462	6,753	4,878
	<u>291,103</u>	<u>285,833</u>	<u>245,731</u>
Expected to be received within 12 months from the reporting date	18,957	25,509	17,063
Expected to be received after 12 months from the reporting date	<u>272,146</u>	<u>260,324</u>	<u>228,668</u>
	<u>291,103</u>	<u>285,833</u>	<u>245,731</u>

All financial investments have been designated as fair value through profit and loss. Financial investments have been allocated between those expected to be received within 12 months and after 12 months.

#### Fair value hierarchy

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable willing parties in an arm's length transaction.

Fair value measurements are based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's view of market assumptions in the absence of observable market information. The Company utilises techniques that maximise the use of observable inputs and minimise the use of unobservable inputs.

The levels of fair value measurement bases are defined as follows:

- Level 1 fair values measured using quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 fair values measured using valuation techniques for all inputs significant to the measurement other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- Level 3 fair values measured using valuation techniques for any input for the asset or liability significant to the measurement that is not based on observable market data (unobservable inputs)

## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 15 Financial Investments (continued)

The following table presents the Company's assets by IFRS 7 hierarchy levels

	Total £'000	Level 1 £'000	Level 2 £'000	Level 3 £'000
As at 31 December 2011				
Debt securities and other fixed income securities	284,641	32,452	252,189	-
Accrued interest	6,462	947	5,515	-
Total financial investments	291,103	33,399	257,704	-
As at 31 December 2010				
Debt securities and other fixed income securities	279,080	34,697	244,383	-
Accrued interest	6,753	872	5,881	-
Total financial investments	285,833	35,569	250,264	-
As at 1 January 2010				
Debt securities and other fixed income securities	240,853	38,564	202,289	-
Accrued interest	4,878	631	4,247	-
Total financial investments	245,731	39,195	206,536	-

All of the Company's level 2 assets have been valued using standard market pricing sources, such as iBoxx, IDC and Bloomberg. In normal market conditions, we would consider these market prices to be observable market prices. However, following consultation with our pricing providers and a number of their contributing brokers, we have considered that these prices are not from a suitably active market and have classified them as level 2.

There have been no significant transfers between levels in 2011 or 2010.

#### 16 Deferred acquisition costs

	Gross 2011 £'000	RI 2011 £'000	Gross 2010 £'000	RI 2010 £'000
As at 1 January	44,679	727	39,291	815
Acquisition costs movement in provision	7,180	81	5,388	(88)
As at 31 December	51,859	808	44,679	727
To be amortised within 12 months from the reporting date				
To be amortised after 12 months from the reporting date	51,859	808	44,679	727

#### 17 Receivables

	2011 £'000	2010 £'000	1 Jan 2010 £'000
Receivables arising out of direct insurance operations - policyholders	59,701	58,154	64,244
- intermediaries	20,615	18,588	14,648
Receivables arising out of reinsurance operations	-	-	1,554
Other receivables	-	46	34
	80,316	76,788	80,480
To be amortised 12 months from the reporting date	80,316	76,788	80,480

**Legal & General Insurance Limited**  
**Notes to the Financial Statements**

**18 Cash and cash equivalents**

	2011	2010	1 Jan 2010
	£'000	£'000	£'000
Cash at bank and in hand	8,261	7,125	5,334
Deposits with credit institutions	11,032	6,206	35,007
	<u>19,293</u>	<u>13,331</u>	<u>40,341</u>

**19 Non-participating insurance contracts**

	Gross 2011	RI 2011	Gross 2010	RI 2010	Gross 1 Jan 2010	RI 1 Jan 2010
	£'000	£'000	£'000	£'000	£'000	£'000
Provision for unearned premiums	152,354	(8,161)	134,457	(7,453)	120,108	(8,372)
Claims outstanding	91,994	(653)	126,050	(754)	108,812	(2,396)
	<u>244,348</u>	<u>(8,814)</u>	<u>260,507</u>	<u>(8,207)</u>	<u>228,920</u>	<u>(10,768)</u>

**Expected net insurance claim cash flows**

	Date of undiscounted cash flow					Carrying value
	0-1 year	1-2 years	2-3 years	3-4 years	4-5+ years	Total
	£'000	£'000	£'000	£'000	£'000	£'000
<b>As at 31 December 2011</b>						
Claims outstanding	60,173	11,996	6,724	4,271	8,177	91,341
<b>As at 31 December 2010</b>						
Claims outstanding	101,940	10,478	5,079	1,796	6,003	125,296
<b>As at 1 January 2010</b>						
Claims outstanding	86,374	8,925	4,385	1,551	5,181	106,416

Insurance cash flows are based on the expected date of settlement

**Movement in claims liabilities**

	Gross 2011	RI 2011	Gross 2010	RI 2010
	£'000	£'000	£'000	£'000
As at 1 January	126,050	(754)	108,812	(2,396)
Claims arising	130,670	(431)	183,363	(636)
Claims paid	(179,457)	458	(161,040)	2,898
Adjustments to prior year liabilities	14,731	74	(5,085)	(620)
As at 31 December	<u>91,994</u>	<u>(653)</u>	<u>126,050</u>	<u>(754)</u>

**Unearned premiums**

	Gross 2011	RI 2011	Gross 2010	RI 2010
	£'000	£'000	£'000	£'000
As at 1 January	134,457	(7,453)	120,108	(8,372)
Movement in provision	17,897	(708)	14,349	919
As at 31 December	<u>152,354</u>	<u>(8,161)</u>	<u>134,457</u>	<u>(7,453)</u>

All unearned premiums are expected to be earned within one year

## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 20 Claims development tables

The tables below present changes in the historical provision for losses and loss adjustment expenses since 2007 and the provision for losses and loss adjustment expenses arising in each subsequent accident year

The top section of the tables illustrates how the estimate of total claims outstanding for each accident year developed over time. The bottom section of the table reconciles the cumulative claims to the amounts appearing in the balance sheet

#### Gross of reinsurance

	2007	2008	2009	2010	2011	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Accident year						
Estimate of ultimate claims costs						
- At end of accident year	294,000	191,000	164,000	174,000	124,500	947,500
- One year later	277,000	189,000	157,000	188,400	-	811,400
- Two years later	276,000	189,000	156,000	-	-	621,000
- Three years later	277,000	189,000	-	-	-	466,000
- Four years later	278,000	-	-	-	-	278,000
Estimate of cumulative claims	278,000	189,000	156,000	188,400	124,500	935,900
Cumulative payments	(275,000)	(184,000)	(150,000)	(165,000)	(75,000)	(849,000)
Outstanding claims provision	3,000	5,000	6,000	23,400	49,500	86,900
Claims handling provision						3,660
Other						1,434
Total claims liabilities recognised in the balance sheet						91,994

#### Net of reinsurance

	2007	2008	2009	2010	2011	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Accident year						
Estimate of ultimate claims costs						
- At end of accident year	280,000	189,000	162,000	173,000	124,500	928,500
- One year later	267,000	188,000	155,000	188,000	-	798,000
- Two years later	265,000	188,000	155,000	-	-	608,000
- Three years later	266,000	188,000	-	-	-	454,000
- Four years later	267,000	-	-	-	-	267,000
Estimate of cumulative claims	267,000	188,000	155,000	188,000	124,500	922,500
Cumulative payments	(266,000)	(184,000)	(148,000)	(163,000)	(75,000)	(836,000)
Outstanding claims provision	1,000	4,000	7,000	25,000	49,500	86,500
Claims handling provision						3,331
Other						1,510
Total claims liabilities recognised in the balance sheet						91,341



## Legal & General Insurance Limited

### Notes to the Financial Statements

21 Trade payables	2011 £'000	2010 £'000	1 Jan 2010 £'000
Payables arising from insurance and reinsurance contracts			
- agents, brokers and intermediaries	15,434	13,378	9,350
- reinsurers	8,588	8,075	12,570
	<u>24,022</u>	<u>21,453</u>	<u>21,920</u>

All trade payables are expected to be settled no more than twelve months after the balance sheet date

22 Other payables	2011 £'000	2010 £'000	1 Jan 2010 £'000
Amounts owed to group undertakings	31,282	27,377	26,636
Other payables	8,142	11,185	23,067
Reinsurance share of deferred acquisition costs	808	727	815
Preference shares (see note 24 for further detail)	3,500	3,500	3,500
	<u>43,732</u>	<u>42,789</u>	<u>54,018</u>

All other payables are expected to be settled no more than twelve months after the balance sheet date

## 23 Contingent liabilities

Provision for the liabilities arising under contracts with policyholders is based on certain assumptions. The variance of actual experience from that assumed may result in such liabilities differing from the provisions made for them.

Liabilities may also arise in respect of claims relating to the interpretation of such contracts, or the circumstances in which policyholders have entered into them (together in this paragraph "liabilities"). The extent of such liabilities is influenced by the actions of the FSA, by ombudsman rulings, by industry compensation schemes and by court judgements. It is not possible to predict with certainty, the extent and the timing of the financial impact to which these liabilities may give rise. The Company considers that it has made prudent provision for such liabilities, as and when circumstances calling for such provision become clear, and that it has adequate capital and reserves to meet all reasonably foreseeable eventualities.

## 24 Share capital

	2011 £'000	2010 £'000	1 Jan 2010 £'000
Authorised			
Equity interests - 3,500,001 ordinary shares of £1 each			
Issued & fully paid - 3,500,000 ordinary shares of £1 each	<u>3,500</u>	<u>3,500</u>	<u>3,500</u>
	2011	2010	1 Jan 2010
Authorised and issued, fully paid			
Preference Shares - 3,499,999 floating rate cumulative preference share of £1 each	<u>3,500</u>	<u>3,500</u>	<u>3,500</u>

Preference shares are included within liabilities in accordance with the requirements of IAS 32

### Rights of preference shareholders

Total dividends for 2011 of £25,000 (2010: £21,000), are payable half yearly on 1 June and 1 December and rank in priority to any other class of shares. On winding-up redemption the preference shareholders are entitled, in priority to any other class of shares, to the capital repayment plus the proportion of dividends due. There are no voting rights attaching to the preference shares other than for a resolution for winding-up the Company or reducing its capital.

## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 25 Retained earnings

	2011	2010
	£'000	£'000
Balance at 1 January	5,855	9,052
Retained profit for the year	23,744	(3,197)
Balance at 31 December	29,599	5,855

#### 26 Holding company

The company's immediate parent undertaking is Legal and General Assurance Society Limited. The ultimate parent company and controlling party is Legal & General Group Plc, a company incorporated in England and Wales.

Legal & General Group Plc is the parent undertaking of the largest group of undertakings to consolidate these financial statements at 31 December 2011. The consolidated financial statements of Legal & General Group Plc are available from the Company Secretary at the Registered Office, One Coleman Street, London, EC2R 5AA or on the Group website, [www.legalandgeneralgroup.com](http://www.legalandgeneralgroup.com).

Legal and General Assurance Society Limited is the parent undertaking of the smallest group of undertakings to consolidate these financial statements at 31 December 2011. The consolidated financial statements of Legal & General Assurance Society Limited are available from the Company Secretary at the address above.

#### 27 Related party transactions

The Company performed a number of transactions with its parent, Legal and General Assurance Society Limited and its fellow subsidiary companies during the normal course of business. Detailed below are the major transactions between these companies:

	2011	2010
	£'000	£'000
a Investment management portfolio	428	404
b Liquidity management	(18)	(18)
c Service charges	-	(30)
d Group expense charges	46,977	44,356
e Interest relating to preference dividends	25	21
f Commission	784	471
g Reinsurance premium	6,020	3,940

- a Legal & General Investment Management (Holding) Limited (LGIM) manage the investment portfolio of the Company
- b Interest charged/(credited) on loan facility by Legal & General Finance Plc at LIBOR plus 0.125%
- c Service charge between Legal and General Assurance Society Limited and the Company
- d Legal & General Group recharges the Company for all direct costs associated with the business and an allocated proportion of centralised costs
- e Preference dividend payable to Legal & General Assurance Society Limited
- f The Company paid commission for business introduced by Legal & General Partnership Services Limited
- g Reinsurance premium accepted by Legal and General Assurance Society Limited as part of a wider reinsurance treaty

There were no material transactions with Directors of the Company during the year, except for those relating to remuneration and shareholding, disclosed in note 9.

## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 27 Related party transactions (continued)

Year end balances payable/ (receivable) arising from transactions with fellow subsidiary companies

	2011	2010	1 Jan
	£'000	£'000	£'000
a Investment management portfolio	36	35	32
b Liquidity management	(7,697)	(9,432)	(8,298)
c Service charges	-	-	-
d Group expense charges	14,819	16,931	16,619
e Interest relating to preference dividends	3	2	2
f Commission	55	38	64
g Reinsurance premium	2,766	2,011	2,055
h Investment in subsidiaries	2,248	2,248	2,248
i Payable to Legal & General Assurance Society Limited	20,583	17,076	15,618
j Receivable from Legal & General Assurance Society Limited	(1,531)	(1,532)	(1,704)
	<u>31,282</u>	<u>27,377</u>	<u>26,636</u>

None of the above balances are secured on the assets of any group undertaking

#### 28 Critical accounting estimates and judgements

##### General comments regarding assumptions and methodology

Actuarial and statistical methods have been applied to the claims data to arrive at the estimates of the claim reserves gross and net of reinsurance. The reserve is the sum of the outstanding case estimates (which are known) plus an amount for claims which have been incurred but have not yet been reported and an allowance for changes in case estimates. The most uncertain element of the reserve is the incurred but not reported (IBNR) amount.

The IBNR reserve can be thought of as the difference between the amount which will ultimately be paid minus the amount that has already been paid minus the amount reserved for as case estimates.

For the household and motor classes of business, IBNR includes not only claims which have not yet been reported, but also the positive or negative development of the case estimates attributed to reported cases, also known as IBNER.

In cases where the claims data provided contains claims handling expenses, these are included and projected in the estimates of the claim reserves. In addition, allowance is made for unallocated claims handling expenses on outstanding and IBNR claims.

A margin is held over and above the best estimate IBNR reserve to allow for the uncertainty in reserves.

Various methods are used to determine the IBNR. The choice of method depends on the class of business and the peril being assessed. The methods are explained below.

##### Projection of incurred claim amounts using the basic chain ladder method

This is a method for estimating the ultimate cost (and therefore the incurred but not reported claims) based on the incurred claims data (i.e. the paid claims plus the notified case estimates).

Development factors are calculated for each origin period which reflect the patterns of claim reporting and payment, and the relative adequacy of the notified case estimates over time. The choice of historic period for determining development factors is a matter of judgement. The method also assumes that inflation, investment income, the economic environment remain unchanged over the origin period selected.

## Legal & General Insurance Limited Notes to the Financial Statements

### 28 Critical accounting estimates and judgements (continued)

#### **Projection of the number of claims reported using the basic chain ladder method and application of average cost per claim methods**

The basic chain ladder method described above is used to project the ultimate number of claims (and therefore the incurred but not reported claims) for each period. The ultimate cost is then estimated by multiplying the ultimate number of claims for each origin year by an appropriate average cost assumption. The average cost assumption is derived by taking account of historical data, trends and external industry data, and applying appropriate judgement.

#### **Exposure based methods**

Exposure based methods estimate the ultimate cost (and therefore the incurred but not reported claims) based on exposure measures relating to the origin years considered. The simplest exposure based method is the expected loss ratio method. The ultimate cost is estimated by multiplying the earned premium for the relevant origin year by an estimate of the loss ratio for that origin year. This selected loss ratio takes account of historical data, trends and other available information such as premium rating activity and requires judgement. This method effectively ignores the actual development of the claims to date for that origin period.

The Bornhuetter-Ferguson approach combines the chain ladder method described above with the expected loss ratio method. This moderates the influence of the current development of the most recent origin years on the estimate of the ultimate cost. This can be beneficial in circumstances where the data for the most recent origin years is sparse or for longer tailed classes.

#### **Key drivers of Uncertainty in the Company's Reserves**

Uncertainty in the Company's reserves can arise from a number of factors both internal and external. For example:

- The downturn in the economy could drive increased IBNR unemployment claims on the Accident, Sickness and Unemployment product, both in terms of increased frequency and increased claim duration.
- On Household, IBNR claims could increase due to the emergence of latent claims for example, in liability following an adverse court judgement, or in subsidence as an improvement in the housing market leads to an increase in surveys and hence a greater number of cracks being noticed.

Given this uncertainty, it is Company policy to hold reserves above the best estimate. Current policy is to hold reserves between the 60th and 65th percentile of the overall distribution. Whilst the precise choice of percentile is a matter of judgement, sensitivity analysis of the reserves, as described in the next section, shows that reserving at this level provides a margin against reasonable levels of uncertainty, whilst avoiding excessive prudence for IFRS reporting purposes.

This chosen level of uncertainty margin is translated into a percentage add-on to the reserves in respect of outstanding reported claims and IBNR for each class of business. As at 31 December 2011, the margins were:

- 15% for ASU
- 3% for Household plus £500,000
- 3% for Motor

As at 31 December 2010, the ASU margin was 10%. This had increased by 31 December 2011 to reflect the increased uncertainty associated with the economic downturn. The motor margin was 15% as at 31 December 2010 and had been reduced to 3% by 31 December 2011 to reflect the reduction in uncertainty of a portfolio in run-off. An additional £500,000 was added to the household margin to reflect additional uncertainty around the development of freeze and subsidence claims. The overall uncertainty remained within the 60-65th percentile range.

#### **Financial Impact of the Uncertainty**

All figures in this section are based on the reserving exercise performed as at 31 December 2011.

## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 28 Critical accounting estimates and judgements (continued)

##### Accident, Sickness and Unemployment

If non reinsurance backed IBNR claims increased by 50% the Company would need to hold an extra 18% of the best estimate reserve (assuming these claims have same average monthly benefit and duration as assumed in the best estimate calculation)

If all non reinsurance backed claimants were to claim for an extra month on top of what was assumed in the best estimate the Company would need to hold an extra 10% of the best estimate reserve

If these two events occurred at the same time the Company would need to hold an extra 29% of the best estimate. However, the probability of this occurrence would be very small

Some economists fear a double dip recession which could result in policyholders claiming on their policy for longer. It could also result in a larger number of IBNR claims than the Company is reserving for

For this reason, a 15% margin does not look unreasonable in the current economic environment

##### Household

The table below shows how much extra the Company would need to hold in pounds if the number of IBNR claims increased by differing percentages. The 3% margin plus £500,000 held in December 2011 amounted to £2.7m

Percentage increase in IBNR claims	Extra reserve required
10%	£574,706
20%	£1,149,413
30%	£1,724,119
40%	£2,298,826
50%	£2,873,532

The table shows that the margin would have been enough to cover just over a 45% increase in IBNR claims

Figures for Motor and Mortgage Payment Protection are not material given the total IBNR of £47,000 as at 31 December 2011

## **Legal & General Insurance Limited**

### **Notes to the Financial Statements**

#### **29 Risk management and control**

The Company's primary objective in undertaking risk management activity is to manage risk exposure in line with risk appetite minimising its exposure to unexpected financial loss and limiting the potential for deviation from anticipated outcomes. In this respect, a framework of limits and qualitative statements, aligned with the Company's risk appetite, is in place for material exposures.

A significant part of the Company's business involves the acceptance and management of risk. The Company operates a formal risk management framework to ensure that all significant risks are identified and managed. Financial risk is categorised as follows:

- Insurance risk
- Market risk
- Credit risk
- Liquidity risk
- Operational risk

#### **Insurance risk**

Insurance risk arises as a consequence of the type and volume of business written and the concentration of risk in particular policies or groups of policies subject to the same risks. Insurance risk is managed using the following techniques:

Policies and delegated authorities for underwriting, pricing and reinsurance

The Company's insurance risk policy sets out the overall framework for the management of insurance risk. As part of the framework, a structure of delegated pricing and underwriting authorities is in place. Pricing is based on assumptions which have regard to past experience and trends. Insurance exposures are limited through reinsurance.

The principal General insurance reinsurances are excess of loss catastrophe treaties, under which the cost of claims from a weather event, in excess of an agreed retention level, is recovered from reinsurers.

Reserving policy

The Company has a documented reserving policy setting out the basis on which liabilities are to be determined using statistical analysis and actuarial experience.

#### **Market risk**

The Company's exposure to market risk is influenced by external factors such as changes in specified interest rates. Interest rate risk is the risk that the Company is exposed to lower returns or loss as a direct or indirect result of fluctuations in the value of, or income from, specific assets and liabilities arising from changes in underlying interest rates. The Company is exposed to interest rate risk on the investment portfolio that is maintained to meet the obligations and commitments in that the proceeds from the assets may not be sufficient to meet the Company's obligations to policyholders.

The sensitivity analysis considers the impact on the value of LGI assets of a 1% change in interest rates (both increase and decrease), and a 1% increase in credit spreads. The calculation is based on the market value and duration of the fixed interest assets in the fund (excluding gilts in the case of a credit spread change). As liabilities are not discounted no change is assumed in the value of liabilities as a result of market risk.

The methods and assumptions used are unchanged from the previous year end.

#### **Capital Risk**

LGI manages capital on the basis of the ICAS regime, as the Pillar 2 capital requirement under this regime is greater than the Pillar 1 capital requirement. Formal submissions of ICA capital are made to the FSA every 2 years, with capital calculations for internal use being completed quarterly. The most recent ICA submission to the FSA was as at 31 December 2010.

The results of the quarterly capital calculations are presented to the LGI Board and the Financial and Insurance Risk Committee. The surplus of available capital (assets less liabilities) compared to the most recent Individual Capital Guidance (ICG) issued by the FSA (or most recent quarterly ICA if higher) is monitored in monthly reporting.

## Legal & General Insurance Limited Notes to the Financial Statements

### 29 Risk management and control (continued)

#### Credit risk

The Company's exposure to credit risk include

- Banking counterparty risk
- Investment counterparty risk
- Reinsurer credit risk
- Premium debtor and supplier prepayment risk

Banking and investment counterparty risks are controlled through limits on the exposure to individual counterparties. Reinsurer credit risk is controlled through a requirement that all reinsurers have S&P ratings of A- or better or AM Best rating of A- or better and who are approved by its reinsurance broker's Security Committee for the type of business being reinsured. Limits are placed on premium and supplier risks to mitigate exposure.

The credit profile of the Company's assets exposed to credit risk is shown in the table below. The credit rating bands are provided by independent rating agencies. For unrated assets, internal ratings are maintained which are used to manage exposure to these counterparties. No provision for impairment has been made at year end on the basis that balances are considered to be recoverable.

	AAA £'000	AA £'000	A £'000	BBB £'000	BB & below £'000	Unrated	Total
<b>As at 31 December 2011</b>							
Government securities	3 055	-	-	-	-	-	3 055
Other fixed rate securities	81 489	18 467	93 422	87 809	-	-	281,187
Variable rate securities	399	-	-	-	-	-	399
<b>Total debt securities</b>	<b>84,943</b>	<b>18,467</b>	<b>93 422</b>	<b>87 809</b>	<b>-</b>	<b>-</b>	<b>284 641</b>
Accrued interest	2,037	250	2,326	1,849	-	-	6 462
Cash and cash equivalents	4 546	6 486	-	-	-	8,261	19 293
<b>Financial assets</b>	<b>91 526</b>	<b>25 203</b>	<b>95 748</b>	<b>89 658</b>	<b>-</b>	<b>8,261</b>	<b>310 396</b>
Reinsurers' share of contract liabilities	43	4 001	4 365	405	-	-	8 814
Other assets	-	-	-	-	-	134 839	134 839
<b>Total</b>	<b>91 569</b>	<b>29,204</b>	<b>100,113</b>	<b>90,063</b>	<b>-</b>	<b>143 100</b>	<b>454 049</b>

	AAA £'000	AA £'000	A £'000	BBB £'000	BB & below £'000	Unrated	Total
<b>As at 31 December 2010</b>							
Government securities	10,623	-	-	-	-	-	10,623
Other fixed rate securities	76,842	25 030	96,504	45 668	8,028	3,562	255 634
Variable rate securities	8 510	-	-	313	4 000	-	12 823
<b>Total debt securities</b>	<b>95 975</b>	<b>25 030</b>	<b>96 504</b>	<b>45 981</b>	<b>12 028</b>	<b>3 562</b>	<b>279,080</b>
Accrued interest	2 252	495	2 846	800	284	76	6 753
Cash and cash equivalents	-	22	6,206	-	-	7 103	13 331
<b>Financial assets</b>	<b>98 227</b>	<b>25 547</b>	<b>105 556</b>	<b>46 781</b>	<b>12 312</b>	<b>10,741</b>	<b>299 164</b>
Reinsurers' share of contract liabilities	38	2 872	4 666	631	-	-	8 207
Other assets	-	-	-	-	-	127 638	127 638
<b>Total</b>	<b>98 265</b>	<b>28,419</b>	<b>110,222</b>	<b>47 412</b>	<b>12,312</b>	<b>138 379</b>	<b>435 009</b>

## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 29 Risk management and control (continued)

##### Liquidity risk

Liquidity risk is the risk that the Company, though solvent either does not have sufficient financial resources available to enable it to meet its obligations as they fall due or can only secure such liquid financial resources either at an excessive borrowing cost relative to that achieved in the recent past or that typically payable by a comparably rated borrower or through the sale of illiquid assets at a price significantly below the fair value of such assets in the recent past

LGI maintains sufficient liquid assets and standby facilities to meet a prudent estimate of the cash outflows that may arise from all contingent events with a probability of occurrence of up to 1 in 200 years as identified through stress and scenario testing and the annual planning process

LGI has entered into a ten-year arrangement with L&G Finance PLC to manage the cash flows of the general insurance business. The arrangement has a maximum loan facility of £100m with no daily draw down limit. This has proved ample for day to day cash management and is sufficient to cover all but the most extreme events modelled in the stress and scenario testing exercise. It is regularly monitored by the LGI Financial and Insurance Risk Committee which seeks to avoid a large balance persisting

The following aspects of liquidity risk are relevant to the Company

**Projected market conditions cash flow risk** - the risk that a change in the economy, market conditions or the business environment may change the size or timing of the financial obligations resulting in the need to increase its liquidity levels

**Cash flow timing risk** - the risk that the actual timing of cash flows may vary to those projected. However, the nature, type and effect of timing differences will differ for those associated with insurance business funds

**Contingent liquidity risk** - the risk from the occurrence of high impact events for which no provision has been made in liquidity forecasts due to the events having an extremely low probability of occurrence. Such events giving rise to contingent liquidity risk may include

- External events, particularly those of a catastrophic nature which may give rise to significant number of claims or policy withdrawals requiring settlement, and
- A significant failure in internal controls either resulting in direct financial loss or the need to pay redress to customers who may have suffered disadvantage as a result of failure

The principal products of the Company are

- **Household** These contracts provide cover in respect of householders' homes, investment properties, contents, personal belongings and incidental liabilities which they may incur as a property owner, occupier and individual. Exposure is normally limited to the rebuilding cost of the home, the replacement cost of belongings and a policy limit in respect of liability claims. The Company uses reinsurance to manage the exposure to an accumulation of claims arising from any one incident, usually severe weather. The catastrophe cover runs from 1 July to 30 June and reinsures the Company for losses between £30m and £265m (2010/2011: £30m and £235m) for a single weather event. A single household policy can result in a large liability claim. To mitigate the risk, accident excess of loss reinsurance is in place for claims in excess of £750m (2010: £750m)
- **Accident, Sickness and Unemployment** These contracts provide cover in respect of continuing payment liabilities incurred by customers when they are unable to work as a result of accident, sickness or unemployment. They protect predominantly mortgage payments. Exposure is limited to the monthly payment level selected by the customer sufficient to cover the payment and associated costs up to the duration limit specified in the policy, usually 12 months



## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 29 Risk management and control (continued)

- **Motor** (in run-off) These contracts provide cover in respect of customers' private cars and their liability to third parties in respect of third party damage. Exposure is normally limited to the replacement value of the vehicle and a policy limit in respect of third party property damage. Exposure to third party bodily injury is unlimited in accordance with the statutory requirements. The motor book continues in run-off, the final policy having expired in August 2007, but this is expected to take several years.
- **Domestic Mortgage Indemnity** These contracts (primarily in run-off) protect a mortgage lender should an insured property be repossessed and subsequently sold at a loss. Since 1993, the contract has included a maximum period of cover of ten years and a cap on the maximum claim. For business accepted prior to 1993, cover is unlimited and lasts until the insured property is remortgaged or redeemed.

#### Operational risk

Internal processes and customer service standards while carefully controlled and managed may fail or be impacted by external factors such as fraud or terrorist action giving rise to adverse customer reaction and a resultant loss to the Company - either a monetary loss or a loss of future sales.

#### Key risk factors

##### Weather events

Significant weather events such as windstorms, and coastal and river floods can lead to significant claims.

##### Concentration

The insurance of properties which are concentrated in high risk areas, or an above average market share in a particular region, can give rise to a concentration of insurance risk. This risk is managed by ensuring that the risk acceptance policy, terms and premiums both reflect the expected claim cost associated with the location and avoid adverse selection. Additionally, exposure and competitor activity is monitored by location to ensure that there is a geographic spread of business. Catastrophic reinsurance cover reduces the Company's exposure to concentration of risk. The catastrophe reinsurance is designed to protect against a modelled windstorm and coastal flood event with a return probability of 1 in 200 years.

##### Subsidence

The incidence of subsidence can have a significant impact on the level of claims on household policies. The Company's underwriting and reinsurance strategy mitigates the exposure to concentrations of risk arising from geographic location or adverse selection.

##### Economic downturn

Periods of rapid and prolonged national economic downturn can create significant variation in the frequency and severity of ASU claims experience.

The risk is managed through the monitoring of economic trends and the underwriting of policies to ensure that the customer completing a mortgage loan transaction achieves credit scoring approval.

##### Unlimited motor claims

A single motor policy can result in major multiple liability claims in extreme scenarios. To mitigate the risk, accident excess of loss reinsurance is in place for claims in excess of £1m (2010: £1m).

## Legal & General Insurance Limited Notes to the Financial Statements

### 29 Risk management and control (continued)

#### Sensitivity analysis

The table below shows material sensitivities for the Company on pre-tax profit and equity net of reinsurance

	Impact on pre-tax profit net of reinsurance 2011 £'000s	Impact on equity net of reinsurance 2011 £'000s	Impact on pre-tax profit net of reinsurance 2010 £'000s	Impact on equity net of reinsurance 2010 £'000s
<b>Sensitivity test</b>				
Single storm event with 1 in 200 year probability	(89 767)	(66 427)	(54 972)	(39 580)
Subsidence event - worst claim ratio in last 30 years	(41 149)	(30 450)	(39,384)	(28 357)
Economic downturn	(42 964)	(31 794)	(38 339)	(27 604)
5% decrease in overall claims ratio	8 851	6 550	8,761	6 308
5% surplus over claims liabilities	4 567	3 380	6,175	4 446

For any single event with claims in excess of £30m (2010 £30m) but less than £265m (2010 £235m), the ultimate cost to the Company would be £30m (2010 £30m). The impact of a 1 in 500 year modelled windstorm and coastal flood event would exceed the catastrophe cover by approximately £192m (2010 £131m).

#### IGD sensitivity analysis

The table below provides management estimates of the impact of IGD surplus to changes in market conditions

	Impact on surplus capital 2011 £'000s	Impact on surplus capital 2010 £'000s
<b>Sensitivity test</b>		
100bps increase in interest rates	72 800	55 400
100bps decrease in interest rates	72 800	68 600
100bps increase in credit spreads	72 900	55 400