

Company Registration No: 02445040

INDEMNITY INSURANCE LIMITED

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2009



**Group Secretariat
The Royal Bank of Scotland Group plc
Gogarburn
P.O. Box 1000
Edinburgh EH12 1HQ**

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INDEMNITY INSURANCE LIMITED

02445040

OFFICERS AND PROFESSIONAL ADVISERS

DIRECTORS

L J Bartlett
I Falconer
P R Geddes
S K Howard
C P Sullivan

SECRETARY

P A Hutchings

REGISTERED OFFICE

Churchill Court
Westmoreland Road
Bromley
Kent
BR1 1DP

AUDITORS

Deloitte LLP
London

Registered in England and Wales.

DIRECTORS' REPORT

The directors present their report and the audited financial statements for the year ended 31 December 2009

ACTIVITIES AND BUSINESS REVIEW**Activity**

The principal activity of the Company continues to be the provision of general insurance

The Company ceased its general insurance underwriting activities in 2007. The Company has continued to be in run-off through 2008 and 2009.

The Company is a subsidiary of The Royal Bank of Scotland Group plc which provides the Company with direction and access to all central resources it needs and determines policies in all key areas such as finance, risk, human resources or environment. For this reason, the directors believe that performance indicators specific to the Company are not necessary or appropriate for an understanding of the development, performance or position of the business. The annual reports of The Royal Bank of Scotland Group plc review these matters on a group basis. Copies can be obtained from Group Secretariat, RBS Gogarburn, Edinburgh EH12 1HQ, the Registrar of Companies or through the Group's website at rbs.com

Review of the year*Business review*

The directors are satisfied with the Company's performance in the year. The Company will be guided by its immediate parent company in seeking further opportunities for growth.

No dividends were paid in 2009 (2008: £nil). The directors do not recommend the payment of a final dividend (2008: £nil).

Financial performance

The Company's financial performance is presented in the Statement of Comprehensive Income on page 6.

Net insurance premium revenue decreased by £925,000 and other income increased by £525,000. Net insurance claims decreased by £343,000. Expenses decreased by £1,462,000. The profit for the year was £1,046,000, an increase of £1,089,000 from 2008.

At the end of the year, the financial position showed total assets of £11,352,000 (2008: £13,494,000), including income generating assets comprising investments of £11,318,000 (2008: £11,080,000), together representing an increase of 15.9% from 2008.

The directors, having made such enquiries as they considered appropriate, including regarding the continuing availability of sufficient resources from the Group, have prepared the financial statements on a going concern basis. They considered the financial statements of The Royal Bank of Scotland Group plc for the year ended 31 December 2009, approved on 24 February 2010, which were prepared on a going concern basis.

The Company seeks to minimise its exposure to external financial risks and the principal uncertainties that arise from those risks. Further information on insurance and financial risk management policies and exposures is disclosed in note 3.

DIRECTORS' REPORT (Continued)**DIRECTORS AND SECRETARY**

The present directors and secretary, who have served throughout the year except where noted below, are listed on page 1

From 1 January 2009 to date the following changes have taken place

	Appointed	Resigned
Directors		
M A Fisher		27 February 2009
G F Pell	21 April 2009	31 July 2009
P R Geddes	12 August 2009	
M A Hesketh		28 August 2009
L J Bartlett	18 September 2009	
S K Howard	18 September 2009	
E J G Smith		15 December 2009
N C McLuskie		11 February 2010

DIRECTORS' RESPONSIBILITIES STATEMENT

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 a directors' report and financial statements for each financial year and the directors have elected to prepare them in accordance with International Financial Reporting Standards 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 at the end of the year and the profit and loss for the financial year as far as concern members of the Company. In preparing these financial statements, under International Accounting Standard 1, the directors are required to

- select suitable accounting policies and then apply them consistently,
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information,
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions of the entity's financial position and performance, and
- make an assessment of the Company's ability to continue as a going concern

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 to enable them to ensure that the directors' report and financial statements comply with the requirements of 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

DISCLOSURE OF INFORMATION TO AUDITORS

Each of the directors at the date of approval of this report confirms that

- (a) so far as he/she are aware, there is no relevant audit information of which the Company's auditors are unaware, and
- (b) the director has taken all the steps that he/she ought to have taken 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 shall be interpreted in accordance with the provisions of section 418 of the Companies Act 2006

DIRECTORS' REPORT (Continued)

DIRECTORS' INDEMNITIES

In terms of section 236 of the Companies Act 2006, Mr L J Bartlett, Mr I Falconer, Mr M A Fisher, Mr P R Geddes, Mr M A Hesketh, Mrs S K Howard, Mr N C McLuskie, Mr G F Pell, Mr E J G Smith, and Mr C P Sullivan had been granted Qualifying Third Party Indemnity Provisions by The Royal Bank of Scotland Group plc

POLICY AND PRACTICE ON PAYMENT OF CREDITORS

The Company follows the policy and practice on payment of creditors determined by The Royal Bank of Scotland Group plc ('RBSG'), as outlined below

RBSG is committed to maintaining a sound commercial relationship with its suppliers. Consequently, it is RBSG's policy to negotiate and agree terms and conditions with its suppliers, which includes the giving of an undertaking to pay suppliers within 30 days of receipt of a correctly prepared invoice submitted in accordance with the terms of the contract or such other payment period as may be agreed

AUDITORS

Deloitte LLP have expressed their willingness to continue in office as auditors

Approved by the Board of Directors
and signed on behalf of the Board



L J Bartlett
Director
18 March 2010

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF INDEMNITY INSURANCE LIMITED

We have audited the financial statements of Indemnity Insurance Limited ("the Company") for the year ended 31 December 2009 which comprise the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes to the accounts 1 to 22. 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.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement, 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 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 (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2009 and of its profit for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

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



Jeremy Casson (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom

18 March 2010

INDEMNITY INSURANCE LIMITED

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**STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2009**

	Notes	2009 £'000	2008 £'000
Insurance premium revenue	5	183	1,108
Net insurance premium revenue		183	1,108
Investment income	6	289	525
Other operating income	7	741	-
Net income		1,213	1,633
Insurance claims and loss adjustment expenses	8	232	(83)
Insurance claims and loss adjustment expenses recovered from reinsurers	8	11	(17)
Net insurance claims		243	(100)
Commission expenses	9	13	(1,413)
Expenses for marketing and administration	9	6	(30)
Expenses		19	(1,443)
Profit before tax		1,475	90
Taxation	10	(429)	(133)
Profit/(loss) for the year	11	1,046	(43)
Other comprehensive income			
Net fair value gain on available-for-sale investments	18	79	114
Tax on other comprehensive income	18	(21)	(33)
Other comprehensive income after tax		58	81
Total comprehensive income after tax		1,104	38

The comprehensive income for the year was entirely attributable to equity shareholders of the Company and is derived from continuing operations

The notes on pages 10 to 43 form part of these financial statements

INDEMNITY INSURANCE LIMITED

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**BALANCE SHEET
AS AT 31 DECEMBER 2009**

	Notes	2009 £'000	2008 £'000
ASSETS			
Prepayments and accrued income		30	-
Financial investments	14	9,867	10,297
Loans and receivables	15	4	2,414
Cash and cash equivalents	16	1,451	783
Total assets		11,352	13,494
EQUITY			
Share capital	17	14,900	14,900
Other reserves	18	143	85
Retained losses	18	(4,288)	(5,334)
Total equity		10,755	9,651
LIABILITIES			
Insurance liabilities	19	92	749
Trade and other payables including insurance payables	20	100	3,058
Current tax liabilities	22	405	36
Total liabilities		597	3,843
Total equity and liabilities		11,352	13,494

The financial statements were approved by the Board of Directors and authorised for issue on 18 March 2010. They were signed on its behalf by



L J Bartlett
Director

The notes on pages 10 to 43 form part of these financial statements

INDEMNITY INSURANCE LIMITED

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**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2009**

	Share capital £'000	Other reserves £'000	Retained earnings £'000	Total £'000
Balance as at 1 January 2008	14,900	4	(5,291)	9,613
Loss for the year	-	-	(43)	(43)
Other comprehensive income	-	81	-	81
Total comprehensive income for the year	-	81	(43)	38
Balance as at 31 December 2008	14,900	85	(5,334)	9,651
Profit for the year	-	-	1,046	1,046
Other comprehensive income	-	58	-	58
Total comprehensive income for the year	-	58	1,046	1,104
Balance as at 31 December 2009	14,900	143	(4,288)	10,755

Total changes in equity for the year were entirely attributable to the equity shareholders of the Company

The notes on pages 10 to 43 form part of these financial statements

INDEMNITY INSURANCE LIMITED
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**CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2009**

	Notes	2009 £'000	2008 £'000
Profit/(loss) for the year		1,046	(43)
Adjustments for			
Investment revenues	6	(289)	(525)
Income tax expense	10	429	133
Interest received		367	465
Income received from other investments		-	-
Operating cash flows before movements in working capital		1,553	30
Net decrease/(increase) in insurance net assets		2,187	(1,887)
Net increase in reinsurance assets		(11)	-
Proceeds on disposal/maturity of available-for-sale debt securities		2,499	-
Purchases of debt securities		(2,068)	(4,584)
Net increase in loans and receivables		(575)	(766)
Net (increase)/decrease in other assets		(8)	381
Net decrease/(increase) in related party balances		141	(518)
Net (decrease)/increase in other operating liabilities		(2,969)	3,045
Cash generated from/(used by) operations		749	(4,299)
Taxes paid		(81)	(29)
Net cash generated from/(used by) operating activities		668	(4,328)
Net increase/(decrease) in cash and cash equivalents		668	(4,328)
Cash and cash equivalents at the beginning of the year	16	783	5,111
Cash and cash equivalents at the end of the year	16	1,451	783

The Company classifies the cash flows for the purchase and disposal of financial assets in its operating cash flows as the purchases are funded from the cash flows associated with the origination of insurance contracts, net of the cash flows from payment of insurance claims

The notes on pages 10 to 43 form part of these financial statements

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****1 ACCOUNTING POLICIES****1.1 Basis of accounting**

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted for use in the European Union. The financial statements also comply with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The financial statements have been prepared on the historical cost basis except that available-for-sale financial assets are stated at their fair value.

The Company has considerable financial resources and as a consequence, the directors believe the Company is well placed to manage its business risks successfully despite the current uncertain economic climate. After making enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, the directors continue to adopt the going concern basis in preparing the annual report and financial statements. The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Activities and Business Review section of the Directors' Report on page 2. In addition, notes 3 and 4 to the financial statements include the Company's objectives, policies and processes for managing its insurance and financial risks and capital.

1.2 Insurance premium revenue

Insurance premiums comprise the total premiums receivable for the whole period of cover provided by contracts inception during the financial year, adjusted by an unearned premium provision, which represents the proportion of the premiums that relate to periods of insurance after the balance sheet date. Unearned premiums are calculated over the period of exposure under the policy, on a daily basis, a 12ths basis, 24ths basis or allowing for the estimated incidence of exposure under policies.

Premiums collected by intermediaries, but not yet received, are assessed based on estimates from underwriting or past experience, and are included in insurance premiums. Insurance premiums exclude insurance premium tax and are shown gross of any commission payable to intermediaries.

1.3 Insurance claims and loss adjustment expenses

Insurance claims are recognised in the accounting period in which the loss occurs. Provision is made for the full cost of settling outstanding claims at the balance sheet date including claims incurred but not yet reported at that date, net of salvage and subrogation recoveries. Costs for both direct and indirect claims handling costs are also included.

The estimation of insurance claims and loss adjustment expenses has been explained in note 2.1.

1.4 Liability adequacy provision

Provision is made for unexpired risks arising where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned premium provision in relation to such policies after the deduction of any acquisition costs deferred. The expected value is determined by reference to recent experience and allowing for changes to the premium rates. The provision for unexpired risks is calculated separately by reference to classes of business that are managed together after taking account of relevant investment returns.

1.5 Reinsurance

The Company cedes reinsurance in the normal course of business, with retention limits varying by line of business. Outwards reinsurance premiums are accounted for in the same accounting period as the premiums for the related direct business being reinsured. Outward reinsurance recoveries are accounted for in the same accounting period as the direct claims to which they relate.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****1 ACCOUNTING POLICIES (Continued)****1.5 Reinsurance (Continued)**

Reinsurance assets include balances due from reinsurance companies for ceded insurance liabilities. Amounts recoverable from reinsurers are estimated in a consistent manner with the outstanding claims provisions or settled claims associated with the reinsured policies and in accordance with the relevant reinsurance contract.

Where the Company is not certain about the collectability of a reinsurance asset or where the reinsurer's credit rating has been downgraded significantly, the Company reduces the carrying value of the asset accordingly and the impairment loss is recognised in the statement of comprehensive income.

1.6 Deferred acquisition costs

Acquisition costs relating to new and renewing insurance policies are matched with the earning of the premiums to which they relate. A proportion of acquisition costs incurred during the year is therefore deferred to the subsequent accounting period to match the extent to which premiums written during the year are unearned at the balance sheet date.

The principal acquisition costs so deferred are commissions paid, third party administration fees and costs associated with the telesales and underwriting staff.

1.7 Revenue recognition (non insurance)

Interest income on financial assets that are classified as loans and receivables or available-for-sale and interest expense on financial liabilities is determined using the effective interest rate method. In the case of loans and receivables this is estimated using the Rule of 78 method and for available-for-sale assets estimates are based on the straight-line method, both of which management has determined are a close approximation to the effective interest rate.

1.8 Financial assets

On initial recognition financial assets are classified into available-for-sale financial assets, designated as at fair value through profit or loss, or loans and receivables.

Available-for-sale – available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Exchange differences resulting from retranslating the amortised cost of currency monetary available-for-sale financial assets are recognised in profit and loss.

Changes in the fair value of available-for-sale financial assets are recognised in other comprehensive income. Interest and premium/discount on acquisition are calculated using the straight-line method and are recognised in other comprehensive income.

Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date, all other regular way purchases are recognised on trade date.

A financial asset is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The appropriate quoted market price for an asset held is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. If conditions have changed since the time of the transaction (e.g. a change in the risk-free interest rate following the most recent price quote for a corporate bond), the fair value reflects the change in conditions by reference to current prices or rates for similar financial instruments, as appropriate.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****1 ACCOUNTING POLICIES (Continued)****1.8 Financial assets (Continued)**

The valuation methodology described above uses observable market data

If the market for a financial asset is not active, the Company establishes fair value by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the Company uses that technique.

Loans and receivables – financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables. These include deposits with credit institutions which are long-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risks of change in value.

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method less impairment.

Loans and receivables principally comprise loans to related parties and other debtors.

Financial assets are derecognised when the rights to receive cashflows from them have expired or where they have been transferred and the Company has also transferred substantially all risks and rewards of ownership.

1.9 Impairment of financial assets

The Company assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as available-for-sale or loans and receivables is impaired. A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Financial assets carried at fair value – when a decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in other comprehensive income and there is objective evidence that the asset is impaired, the cumulative loss is removed from other comprehensive income and recognised in the statement of comprehensive income. The loss is measured as the difference between the amortised cost of the financial asset and its current fair value. Impairment losses on available-for-sale equity instruments are not reversed through the statement of comprehensive income, but those on available-for-sale debt instruments are reversed, if there is an increase in fair value that is objectively related to an event subsequent to the recognition of the impairment.

Loans and receivables – If there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables has been incurred, the Company measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and its recoverable amount. Impairment losses are assessed individually where significant or collectively for assets that are not individually significant.

Impairment losses are recognised in the statement of comprehensive income and the carrying amount of the financial asset or group of financial assets is reduced by establishing an allowance for the impairment losses. If in a subsequent period the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****1 ACCOUNTING POLICIES (Continued)****1 10 Foreign currencies**

The Company's financial statements are presented in sterling which is the functional and presentation currency of the Company

Transactions in foreign currencies are translated into sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date. Foreign exchange differences arising on translation are recognised in the statement of comprehensive income. Non-monetary items denominated in foreign currencies that are stated at fair value are translated into sterling at foreign exchange rates ruling at the dates the values were determined.

1 11 Taxation

Provision is made for taxation at current enacted rates on taxable profits, arising in income or in equity, taking into account relief for overseas taxation where appropriate.

Deferred taxation is accounted for in full for all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes, except in relation to overseas earnings where remittance is controlled by the Group, and goodwill.

Deferred tax assets are only recognised to the extent that it is probable that they will be recovered.

1 12 Transactions with related parties

IFRS requires all entities to disclose related party transactions.

1 13 Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and on demand deposits with banks together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

Under IAS 7 the Company is producing a cash flow statement using the indirect method. This shows an explanation of the movement in cash and cash equivalents as defined above.

1 14 Accounting developments

The International Accounting Standards Board published a revised IFRS 3 'Business Combinations' and related revisions to IAS 27 'Consolidated and Separate Financial Statements' following the completion in January 2008 of its project on the acquisition and disposal of subsidiaries. The standards improve convergence with US GAAP and provide new guidance on accounting for changes in interests in subsidiaries. The cost of an acquisition will comprise only consideration paid to vendors for equity; other costs will be expensed immediately. Groups will only account for goodwill on acquisition of a subsidiary; subsequent changes in interest will be recognised in equity and only on a loss of control will there be a profit or loss on disposal to be recognised in income. The changes are effective for accounting periods beginning on or after 1 July 2009 but both standards may be adopted together for accounting periods beginning on or after 1 July 2007. These changes will affect the Company's accounting for future acquisitions and disposals of subsidiaries.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****1 ACCOUNTING POLICIES (Continued)****1.14 Accounting developments (Continued)**

In May 2008, the IASB issued amendments to IFRS 1 'First-time Adoption of International Financial Reporting Standards' and IAS 27 'Consolidated and Separate Financial Statements' that change the investor's accounting for the cost of an investment in a subsidiary, jointly controlled entity or associate. It does not affect the consolidated accounts but may prospectively affect the Company's accounting and presentation of receipts of dividends from such entities.

The IASB issued amendments to a number of standards in April 2009 as part of its annual improvements project. The amendments are effective for accounting periods beginning on or after 1 January 2010 and are not expected to have a material effect on the Company.

The IASB issued an amendment, 'Group Cash-settled Share-based Payment Transactions', to IFRS 2 'Share-based Payment' in June 2009 that will change the accounting for share awards by permitting accounting for equity settlement only by entities that either grant awards over their own equity or have no obligation to settle a share-based payment transaction. The amendment is effective for accounting periods beginning on or after 1 January 2010 and is not expected to have a material effect on the Company.

The IASB published an amendment 'Classification of Rights Issues' to IAS 32 'Financial Instruments: Presentation' and consequential revisions to other standards in October 2009 to improve the accounting for issues of equity for consideration fixed other than in the reporting entity's functional currency. The amendment is effective for accounting periods beginning on or after 1 February 2010 but it may be adopted earlier. It is not expected to have a material effect on the Company.

The IASB reissued IAS 24, 'Related Party Disclosures', in November 2009 clarifying the existing standard and to provide certain exemptions for entities under government control. The revised standard is effective for accounting periods beginning on or after 1 January 2011 and is expected generally to reduce the volume of disclosure between the Group and other parties related to the UK Government.

The International Financial Reporting Interpretations Committee (IFRIC) issued interpretation IFRIC 17 'Distributions of Non-Cash Assets to Owners' and the IASB made consequential amendments to IFRS 5 'Non-Current Assets Held for Sale and Discontinued Operations' in December 2008. The interpretation requires distributions to be presented at fair value with any surplus or deficit to be recognised in income. The amendment to IFRS 5 extends the definition of disposal groups and discontinued operations to disposals by way of distribution. The interpretation is effective for accounting periods beginning on or after 1 July 2009, to be adopted at the same time as IFRS 3 (revised 2008), and is not expected to have a material effect on the Company.

The IFRIC issued interpretation IFRIC 18 'Transfers of Assets from Customers' in January 2009. The interpretation addresses the accounting by suppliers that receive assets from customers, requiring measurement at fair value. The interpretation is effective for assets from customers received on or after 1 July 2009 and is not expected to have a material effect on the Company.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****1 ACCOUNTING POLICIES (Continued)****1 14 Accounting developments (Continued)**

The IASB published an amendment to IAS 39, 'Financial Instruments Recognition and measurement' on 'Eligible hedged items'. This amendment makes two significant changes. It prohibits designating inflation as a hedgeable component of a fixed rate debt. It also prohibits including time value in the one-sided hedged risk when designating options as hedges. The amendment is effective for accounting periods beginning on or after 1 July 2009 and must be applied retrospectively in accordance with IAS 8, 'Accounting policies'. This amendment is not expected to have a material effect on the Company.

The IASB published in November 2009, IFRS 9, 'Financial instruments' on classification and measurement. 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 is at fair value through profit or loss. The standard is effective for accounting periods beginning on or after 1 January 2013. These changes will affect the Company's accounting for debt securities.

The IASB published in July 2009, an amendment to IFRS 1 on first time adoption of IFRS additional exemptions. These amendments exempt entities using the full cost method from retrospective application of IFRSs for oil and gas assets and exempt entities with existing leasing contracts from reassessing the classification of those contracts in accordance with IFRIC 4. The amendment is effective for accounting periods beginning on or after 1 January 2010 and is not expected to have a material effect on the Company.

The IFRIC issued interpretation IFRIC 19 'Extinguishing financial liabilities with equity instruments' in November 2009. This IFRIC clarifies the accounting when an entity renegotiates the terms of its debt with the result that the liability is extinguished through the debtor issuing its own equity instruments to the creditor. A gain or loss is recognised in the statement of comprehensive income based on the fair value of the equity instruments compared to the carrying amount of the debt. The interpretation is effective for accounting periods beginning on or after 1 July 2010, and is not expected to have a material impact on the Company.

The IFRIC issued an amendment to IFRIC 14, 'Prepayments of a minimum funding requirement' in November 2009. This amendment will have a limited impact as it applies only to companies that are required to make minimum funding contributions to a defined benefit pension plan. It removes an unintended consequence of IFRIC 14 related to voluntary pension prepayments when there is a minimum funding requirement. The amended interpretation is effective for accounting periods beginning on or after 1 January 2011, and is not expected to have a material impact on the Company.

1 15 Adoption of new and revised Standards

In the current year, the following new and revised Standards and Interpretations have been adopted and have affected the amounts reported in these financial statements:

IAS 1 (Revised) Presentation of Financial Statements

The IASB issued revised IAS 1 Presentation of Financial Statements in September 2007 which is effective for the financial years beginning on or after 1 January 2009. This standard requires all owner changes in equity to be presented in a statement of changes in equity, and all non-owner changes either in one statement of comprehensive income or in two separate statements which are income statement and a statement of comprehensive income. The previous standard required components of comprehensive income to be presented in the statement of changes in equity. The revised standard also requires that the income tax effect of each component of comprehensive income be disclosed. In addition, it requires entities to present a comparative statement of financial position as at the beginning of the earliest comparative period when the entity has applied an accounting policy retrospectively, makes a retrospective restatement, or reclassifies items in the financial statements.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****1 ACCOUNTING POLICIES (Continued)****1 15 Adoption of new and revised Standards (Continued)****Amendment to IFRS 7 Financial Instruments Disclosures**

The IASB published an amendment to IFRS 7 in March 2009. In particular, the amendment requires disclosure of the level of the fair value hierarchy into which fair value measurements are categorised based on a three level fair value hierarchy for financial instruments, a detailed reconciliation from beginning to ending balances for those instruments where significant unobservable inputs or valuation techniques have been used in their valuation, and a movement analysis between the different levels of the fair value hierarchy and the reasons for those movements. In addition, the amendment provides further clarification around liquidity risk disclosures and additional quantitative disclosures based on liquidity risk of financial liabilities.

The amendment applies for financial years beginning on or after 1 January 2009.

Listed below are Standards and Interpretations that have been issued, which became applicable for this year, but had no impact on the reported results nor the financial position.

- IFRS 1 (Revised 2008) First-time adoption of International Financial Reporting Standards – Cost of an investment in a Subsidiary, Jointly Controlled Entity or Associate (Amendment),
- IFRS 2 Share-Based Payment (Amendment),
- IAS 27 Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity (Amendment),
- IAS 39 Financial Instruments Recognition and Measurement and IFRS 7 Financial Instruments Disclosures (Amendment),
- IAS 32 Financial Instruments Presentation and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation,
- IFRIC 13 Customer Loyalty Programmes,
- IFRIC 15 Agreement for the Construction of Real Estate, and
- IFRIC 16 Hedges of a Net Investment in a Foreign Operation

The following amendments were made as part of Improvements to IFRSs (2008). These improvements did not affect the reported results nor the financial position of the Company.

- amendment to IAS 38 Intangible Assets,
- amendment to IAS 40 Investment Property,
- amendment to IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, and
- amendment to IFRS 2 Share-based payment-vesting conditions and cancellations

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****2 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS**

The reported results of the Company are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. The Company's principal accounting policies are set out on pages 10 to 16. UK company law and IFRS require the directors, in preparing the Company's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's Framework for the Preparation and Presentation of Financial Statements.

The judgements and assumptions involved in the Company's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Company would affect its reported results.

2.1 Outstanding claims provisions

Provisions are determined by management based on experience of claims settled and on statistical models which require certain assumptions to be made regarding the incidence, timing and amount of claims and any specific factors such as adverse weather conditions. In order to calculate the total provision required, the historical development of claims is analysed using statistical methodology to extrapolate, within acceptable probability parameters, the value of outstanding claims (gross and net) at the balance sheet date. Also included in the estimation of outstanding claims are factors such as the potential for judicial or legislative inflation.

For more recent claim periods the provisions will make use of techniques that incorporate expected loss ratios. As periods mature, the reserves are increasingly driven by methods based on actual claims experience. The approaches adopted take into account the nature, type and significance of the business and the type of data available, with large claims generally being assessed separately. The data used for statistical modelling purposes is internally generated.

The calculation is particularly sensitive to the estimation of the ultimate cost of claims for the particular classes of business at gross and net levels, the estimation of future claims handling costs and the rate of investment return assumed in the calculation.

Outstanding claims provisions at 31 December 2009 amounted to £92,000 (2008: £749,000).

2.2 Impairment provisions – financial assets

Available-for-sale – the Company determines that available-for-sale financial assets are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Company evaluates among other factors, the normal volatility of share price, the financial health of the investee, industry and sector performance, changes in technology and operational and financing cash flow. Impairment may be appropriate when there is evidence of deterioration in these factors.

Each month, the Company reviews whether there is any objective evidence that the direct investments in debt securities are impaired based on the following criteria:

- price performance of a particular debt security, or group of debt securities, demonstrating an adverse trend compared to the market as a whole,
- adverse movements in the credit rating for corporate debt, and/or
- actual, or imminent, default on coupon interest or nominal.

Impairment provisions on available-for-sale financial assets at 31 December 2009 amounted to £nil (2008: £nil).

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****2 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)****2.2 Impairment provisions – financial assets (Continued)**

Had all the declines in fair values below cost been considered significant or prolonged, the Company would suffer a £16,251 loss in its 2009 financial statements (2008 £75,178), being the transfer of the total equity reserve for unrealised losses to the statement of comprehensive income

2.3 Fair value

Financial assets classified as available-for-sale are recognised in the financial statements at fair value. In the balance sheet, financial assets carried at fair value are included within available-for-sale debt securities and equity shares. Unrealised gains and losses on available-for-sale financial assets are recognised directly in other comprehensive income unless an impairment loss is recognised.

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 values are determined by reference to observable market prices where available and reliable. Where representative market prices for an instrument are not available or are unreliable because of poor liquidity, the fair value is derived from prices for its components using appropriate pricing or valuation models that are based on independently sourced market parameters.

The Company closely monitors the valuation of assets in markets that have become less liquid. Determining whether a market is active requires the exercise of judgement and is determined based upon the facts and circumstances of the market for the instrument being measured. Where it is determined that there is no active market, fair value is established using a valuation technique as described in note 1.13 above. The techniques applied incorporate relevant information available and reflect appropriate adjustments for credit and liquidity risks. The relative weightings given to differing sources of information and the determination of non-observable inputs to valuation models can require the exercise of significant judgement. Where possible, the Company seeks at least external quotations for each bond and considers whether these are representative of fair value in the light of current traded levels, and in comparison to the internal group valuation models. Where this information is not available or where it is considered to be not representative of fair value, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

The fair value of certain asset backed securities has been determined by use of an internal model which predicts the future cashflows from the instruments in a number of projected economic scenarios. These economic scenarios are probability weighted based on recent economic forecasts and the resulting cash flows are discounted using risk adjusted discount rates determined by reference to currently observable market discount rates adjusted to take account of the risk characteristics of the securities being valued. There is significant subjectivity in this valuation as there is little recent market activity in these or other similar instruments.

The fair value of available-for-sale financial assets at 31 December 2009 amounted to £9,867,000 (2008 £10,297,000) and 100% were determined using observable market inputs (2008 100%).

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK

The Company issues contracts that accept insurance risk in return for a premium. It also has financial risk exposures. This section summarises these risks and the way the Company manages them.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)**

The Company is an entity within RBS Insurance which constitutes the Insurance Division of The Royal Bank of Scotland Group plc (the RBS Group) and benefits from services provided by specialist teams and risk management procedures and controls which are applied across the Division. Within RBS Insurance, risk is managed both by the individual entity and on a combined basis across the Insurance Division, and this is explained in more detail in the sections below.

The Company is regulated by the Financial Services Authority (FSA).

3.1 Risk management**3.1.1 Risk management within RBS Group**

The management of risk is a fundamental management activity performed throughout all the Group's operations. As such it underpins the Group's reputation, performance and future success. It is, therefore, critically important that the adequacy and effectiveness of the Group's risk management processes are of the highest standard and subject to continuous review and enhancement.

The Group has put in place a comprehensive risk management framework comprising:

- leadership, strategy and culture set by the Board and put into effect through Executive Management,
- policies, procedures, processes and systems to execute effective risk management throughout the Group,
- comprehensive committee structure operating at Group level to direct, approve and review actions taken to manage risk. Where appropriate this is replicated at a Divisional level,
- Risk Management functions that are independent of the business management to enforce agreed policy.

A number of high-level committees support the Board in the effective measurement and management of risk.

3.1.2 RBS Group policy framework

The RBS Group has developed, and adopted globally, one comprehensive Group Policy Framework. The aim of the Group Policy Framework is to provide a simplified and effective framework to standardise presentation and control of Group policy including new policies and amendments. All employees have easy access to current Group policies and policy standards through a single Group intranet site.

Group Policies address the major areas of risk to the Group and the standards that must be met to enable those risks to be managed in line with Group risk appetite. All Group Policies must be approved by the Executive Committee (ExCo).

3.1.3 RBS Insurance specific risk management

There are significant regulatory and practical differences between the management of risk for banks and that for insurance firms. RBS Insurance therefore has its own risk policies and associated minimum standards, approved by RBS Group, for the following key risk types:

- Insurance risk policy and minimum standards,
- Liquidity risk policy and minimum standards,
- Credit risk policy,
- Market risk policy, and
- Operational risk policy.

A summary of the objectives of each of the Insurance specific risks faced by the Company are described below. The risks associated with market, credit and liquidity risks are described further in the Financial risk in note 3.3 below. Operational risk policy is described in note 3.3.5.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)****3.1.4 Insurance risk policy and minimum standards**

The primary objective of the Insurance Risk Policy is to detail the approach to ensure that all aspects of Insurance Risk are appropriately managed within the Company

The policy is also aimed at ensuring that the Company meets the relevant requirements of RBS Group Market Risk Management (who are responsible for Insurance Risk Management from a Group perspective) and the Financial Services Authority (FSA), as well as embedding best practice and facilitating as high a level of Insurance Risk Management as is feasible

Compliance with this policy ensures that the Company stays within its stated risk appetite. The policy is, therefore, kept under constant review to take into account any changes in the Company's objectives, including changes in the strategy, business plans and risk appetite

The Insurance Risk Policy has associated Minimum Standards which detail how the policy requirements will be met. The types of risk deemed to be covered within the scope of insurance risk minimum standards are

- **Pricing and underwriting** - how the pricing and underwriting strategy is set, controlled, monitored and modified, how breaches of risk appetite are identified and handled, how price changes are decided, implemented and the impact monitored, how policy terms and conditions are decided, applied and monitored etc ,
- **Claims management** - how the claims strategy is set, controlled, monitored and modified, how claims are assessed, how individual claims reserves are determined, reviewed and updated, how recoveries are handled, how claims inflation is set, monitored and controlled, how the claims cost is controlled, including how suppliers are controlled, how claims handling authority limits are monitored, how claims fraud and general leakage is monitored and managed,
- **Reinsurance** - how the reinsurance strategy is set, controlled, monitored and modified, how the exposure to reinsurers is assessed, controlled and monitored, how recoveries are identified and controlled, how concentration risk is managed and monitored,
- **Reserving** - how the reserving strategy is set, controlled, monitored and modified, how the technical reserves are assessed, reviewed, monitored and updated, including oversight procedures

3.1.5 Top down risk management

In order to consider the key risks which pose a material threat to the Company's strategic objectives or to the Company's profit and capital, a 'top down' risk policy and process has been developed and approved

In accordance with the Top Down Risk Management Policy, the Company uses a high-level risk register (HLRR) to record the major risks faced by the business. This register has been used to determine risks which have been subjected to stress and scenario analysis in quantitative modelling. The potential profit variance arising from these stress and scenario tests is used to assess the Company's exposure to each of these risks

'Business as usual' risks and their mitigating controls for each category and the Central Functions are recorded within each area's Risk and Control Register. These risks are reviewed at least monthly by the area/register owner, and by the central RBS Insurance Risk Team (Divisional Risk) on a quarterly basis. The Risk and Control Registers focus on business facing risks and predominantly comprise operational risks. Although other risk types such as insurance and credit risk are not specifically excluded, the key requirement is the documentation of operational risks which threaten business processing. Risks contained in the Risk and Control Registers are subject to ongoing review and control testing to ensure that risks are managed within operational risk appetite. A materialised risk identification, reporting and resolution process takes place to ensure that corrective actions are taken in response to any unacceptable operational weakness

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)****3.1 Risk management (Continued)****3.1.5 Top down risk management (Continued)**

The responsibility for ensuring that the Company has sufficient capital to meet its liabilities rests with the Board. To this end the Company carries out detailed capital modelling of its assets, liabilities and the key risks to which it is exposed. This work feeds into the Company's own assessment of its capital requirements for solvency purposes in the submission of its Individual Capital Assessment (ICA) to the FSA quantifying the following categories of risk: insurance risk, market risk, credit risk, liquidity risk, operational risk, and group risk.

The Board is closely involved in the ICA process and signs off on its assumptions and results. Specifically, the following are fundamental areas that the Board has key involvement in:

- completion of a HLRR for each Business Category or Central Function, input to the aggregated HLRR for RBS Insurance as a whole, sign-off of the final HLRR and regular review (at least quarterly) of the HLRR,
- assessment of the risk appetite in relation to strategy and business plans,
- input to, review and approval of stress and scenario tests, attendance at the scenario workshops as required by the facilitators,
- sign off of the parameter setting for the DFA (Dynamic Financial Analysis) modelling,
- review and sign off of the output from DFA models and other quantitative modelling, and
- review, agreement and sign off of the ICA submission to the FSA, including any surrounding documentation, policies, explanations and assumptions.

The Company seeks to engender an awareness of and a shared responsibility for risk management at all levels of the organisation. The Company's Insurance Risk Appetite Policy supports this. Risk Appetite can be described as the willingness of The Company to tolerate risk related to the pursuit of its approved business activities and objectives. Risk Appetite is restricted to, and limits are set for, approved lines of business. Insurance Risk can be measured as follows:

- Level one – Individual limits

This is expressed in terms of the type of business transacted, (e.g. product types that are underwritten) and the maximum limits per individual risk by these product types. This is captured in a risk appetite matrix of underwriting limits expressed as a function of products and limits.

- Level two – Aggregate limits

This can be expressed in terms of the aggregate volume of business for a particular class (exposure and premium as recorded in business plans, business category budget plans and subsequent quarterly re-forecast plans of each business unit).

- Level three – Mitigated risk

This can be expressed in terms of the potential profit variance which could result from the risks accepted, this will include the quantification of major risks to the business as outlined in the HLRR scenario analysis, based on modelling of these risks on a 1:200 year event as defined in the FSA ICA submission.

To enable the Company to monitor, control and manage the level of risk effectively against Risk Appetite Statements a control environment has been developed which consists of the following:

- clearly defined management responsibilities and organisational structures,
- process for delegated limits of authority,
- appropriate policies and procedures (in line with FSA Senior Management Arrangements Systems and Controls rules (SYSC)),
- accounting controls and reconciliations,
- management reporting systems comprising information of Key Performance Indicators and Key Risk Indicators,
- structured budget and reforecast process,
- personnel requirements for key positions (FSA controlled functions rules),
- segregation of duties, and
- regular internal review and audit mechanisms.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)****3.2 Insurance risk**

Insurance risk can arise from

- fluctuations in the timing, frequency and severity of insured events, relative to the expectations of the Company at the time of underwriting,
- inaccurate pricing at underwriting,
- inadequate reinsurance protection,
- inadequate reserves, and
- concentration of business leading to unexpected claims from a single source

The Company predominantly underwrites personal lines insurance including travel and pet insurance. Contracts are issued typically on a single or annual basis, which means that the Company's liability usually extends for a 12-month period, after which the Company is entitled to decline to renew or can impose renewal terms by amending the premium or excess or both.

3.2.1 Underwriting and pricing risk

Underwriting and pricing risk is the risk that inappropriate business will be written and/or inappropriate prices charged.

The classes and sectors of business written, underwriting criteria, and relevant limits, define underwriting risk appetite.

The Company manages this risk through a wide range of processes and forums, some of which include

- underwriting guidelines which exist for all business transacted restricting the types and classes of business that may be accepted,
- exception reports and other underwriting monitoring tools,
- comprehensive internal quality review audit programmes,
- pricing policies which are set by management and implemented through pricing committees by product line and by brand,
- central control, within underwriting, of policy wordings and any subsequent changes,
- insurance risk framework that involves, among other things, regular minuted meetings where all aspects of insurance risk are discussed, and additional meetings where detailed claims data are examined and discussed,
- weekly monitoring within the business of key performance indicators by product and brand,
- formal monthly monitoring and reporting to the Executive, by product and brand, and
- annual budgeting and quarterly re-forecasting, signed off by the Company Executive.

The following paragraphs explain the frequency and severity of specific risks under the key classes that the Company is exposed to:

a) Travel insurance contracts

The main causes of travel insurance claims are medical expenses incurred from the illness of or accident to the insured while on a trip, loss or theft of their personal possessions and cancellation of the trip before departure due to illness or accident of the insured or a close relative.

Policies can either be on a single trip, or annual basis where all trips taken in a 12-month period are covered. Either way the risk factors are the age and state of health of the insured, the destinations of trips, the activities to be undertaken on the trip, and the duration.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)****3.2.1 Underwriting and pricing risk (Continued)****b) Pet insurance contracts**

The main cause of claims is the incurring of vet fees to treat a sick dog or cat. Vet fee inflation is an issue that the Company deals with by rate and excess increases. Liability to third parties for accidents caused by the animal are also covered. Policies are either annually or monthly renewable. The species (cat or dog), age and breed of the animal are prime risk factors, as well as the postcode of its owner.

The following paragraphs explain the source of uncertainty in respect of the specific key classes of business.

a) Travel insurance contracts

The main source of variability are large individual claims or events such as motor accidents or coach crashes, natural catastrophes or acts of terrorism. The Company mitigates these risks by buying excess of loss reinsurance.

b) Pet insurance contracts

Large liability claims are few and far between, but the Company protects itself from them by buying appropriate reinsurance.

3.2.2 Claims management risk

Claims management risk is the risk that claims are paid or handled inappropriately.

Claims are managed utilising a range of IT-system driven controls coupled with manual processes outlined in detailed policies and procedures to ensure claims are handled in an appropriate, timely and accurate manner.

Each member of staff has a specified handling authority, with controls preventing claims staff handling or paying claims outside of their authorities, as well as controls to avoid paying invalid claims. In addition, there are various outsourced claims handling arrangements all of which are monitored closely by management, with similar principles applying in terms of the controls and procedures.

Loss adjusters are used in certain circumstances to handle claims to conclusion. This involves liaison with the policyholder, third parties, suppliers and management.

3.2.3 Reinsurance risk

Reinsurance risk arises from a failure of reinsurance to control exposure to losses, to reduce volatility or to protect capital.

RBS Insurance uses reinsurance

- to protect the insurance results against the impact of major catastrophic events, e.g. flood, storm,
- to protect the insurance results against unforeseen volumes of, or adverse trends in, large individual claims, in order to reduce volatility and to improve stability of earnings, and
- to transfer risk that is not within the Company's current risk retention strategy.

RBS Insurance reviews its reinsurance purchases at least annually to ensure that the levels of protection being bought reflect any changes in exposure and risk appetite of the group.

Reinsurance is only effective when the counterparty is financially secure. Before entering into a contract with a new reinsurer, it must satisfy the Credit Risk Approval process that uses information derived internally and from security ratings agencies. Acceptable reinsurers are rated at A- or better by Standard & Poor's ratings agency unless specifically authorised by the RBS Insurance Board.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3.2.4 Reserving risk

Reserving risk relates to both premium and claims. It is the risk that reserves are assessed incorrectly such that insufficient funds have been retained to pay or handle claims as the amounts fall due, both in relation to those claims which have already occurred (in relation to claims reserves) or will occur in future periods of insurance (in relation to premium reserves).

It is the Company's policy to hold undiscounted claims reserves (including reserves to cover claims which have occurred but not been reported (IBNR reserves)) for all classes at a sufficient level to meet all liabilities as they fall due.

Reserving risk is controlled through a range of processes, the most significant ones being:

- regular periodic reviews of the claims reserves for the main classes of business by the internal actuarial team,
- the use of internal actuaries to periodically review the adequacy of the reserves for the major classes, and
- oversight of the reserving process by the Board of the Company.

The following table summarises earned premiums and the claims incurred together with the corresponding loss ratios for each major class of business on a gross and net of reinsurance basis for the two most recent financial years.

		2009			2008		
		Earned premiums £ '000	Claims Incurred £ '000	Loss Ratio %	Earned premiums £ '000	Claims Incurred £ '000	Loss Ratio %
Travel	Gross	178	(184)	(103)%	718	(353)	(49)%
	Net	178	(195)	(109)%	718	(336)	(47)%
Pet	Gross	5	(48)	(1,014)%	390	436	112%
	Net	5	(48)	(1,014)%	390	436	112%
Total	Gross	183	(232)	(127)%	1,108	83	8%
	Net	183	(243)	(133)%	1,108	100	9%

3.3 Financial risk

The Company is exposed to financial risk through its financial assets and financial liabilities. The Company's financial risk is concentrated within its investment portfolio. This portfolio is managed in accordance with the RBS Insurance Investment Policy and Investment Guidelines. These are drawn up in compliance with the objectives and risk appetite parameters set by RBSG and are approved by the RBS Insurance Group Limited Board. The Investment Policy is operated by the Investment Committee, which is made up of Senior Executives of both the Insurance Division and the Company, and executed on their behalf by the Funds Management Committee (FMC).

The Investment Committee determines high-level policy and controls, covering such areas as safety, liquidity and performance. It meets at least half-yearly to evaluate risk exposure, the current strategy and to consider investment recommendations submitted to it. Any strategic changes are included in a revised terms of reference for the FMC and the Company's Investment Policy and Guidelines are updated to reflect the changes.

The objectives set out in the Investment Policy are:

- to maintain safety of the portfolio's principal both in economic terms and from an accounting and reporting perspective,
- to maintain sufficient liquidity to provide cash requirements for operations, and
- to maximise the portfolio's total return within the constraints of the other objectives and the limits defined by the Investment Guidelines.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)****3.3 Financial risk (Continued)**

The portfolio is split between Operating Funds and Long-Term Funds to achieve these objectives. Operating Funds which must be at least 35% of the total portfolio are required to support current business operations, identified liabilities and to provide an adequate safety margin. The remainder of the portfolio is classified as long term.

The Investment Guideline set out asset allocation rules and controls for each component part of the portfolio as follows:

Operating Funds

The Operating Funds segment of the investment portfolio shall only be invested in high-quality liquid fixed and floating rate interest securities and in cash (bank deposits). Qualifying investments include:

- bank deposits,
- certificates of deposit (CDs) and commercial paper (CP),
- floating rate notes (FRNs),
- government securities with maturities up to five years (including index linked), and
- listed debt securities with maturity up to five years.

Investments should be managed to ensure a reasonably even spread of maturities over the forthcoming three-month period. In addition, the maturity profile must take account of any potential market price reduction due to interest rate or credit risk.

Long-Term Funds

In addition to those mentioned in under Operating Funds, to achieve its investment objective, the Long-Term Funds segment of the investment portfolio may be invested in the following asset classes:

- equities,
- property,
- fixed interest debt securities (five to fifteen years), and
- floating rate debt securities (up to forty years).

In general, the long-term fund will be invested in a manner such that at least 90% (by market value) of the investments are admissible assets for regulatory purposes.

Opportunistic investments in individual equity stocks will also be allowed up to a maximum of £100m and will be held as an Individual Equity Fund. This type of investment purchased for this portfolio would typically be those which are of undoubted credit quality and offer a good dividend yield. It is likely that such stocks would be liquid and traded on one of the major world stock exchanges.

The most important components of financial risk are market risk, credit risk and liquidity risk.

3.3.1 Market risk

Market risk encompasses any adverse movement in the value of assets as a consequence of market movements such as interest rates, credit spreads, foreign exchange rates, equity prices and property valuations.

The Company is exposed to market risk in both the value of its liabilities and the value of assets held. The Company does not hold investments for trading purposes. Exposure to market risk in the investment portfolio is managed in accordance with the guidelines set out in the Company's Investment Policy as detailed above. The FMC is responsible for ensuring that the Company is compliant with the standards and limits set out in the Investment Policy and Guidelines. The compliance of controls in respect of market risk is reported to the FMC on at least a monthly basis.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3.3.1 Market risk (Continued)

The Company assesses the financial impact from changes in market risk through DFA modelling and stress testing adopted as part of the Individual Capital Assessment (ICA) process. These tests are designed to consider the impact on capital arising from various scenarios based on changes in the financial circumstances and budget assumptions.

Interest rate risk

Interest rate risk arises primarily from the Company's investments in long-term debt and fixed income securities, which are exposed to fluctuations in interest rates.

For claims reserves, the Company does not have exposure to interest rate risk in that the amount of claims reserves do not change as a result of interest rate movements as they are undiscounted.

A table showing the sensitivity of profits to changes in interest rates is included below.

Valuation risk

Valuation risk arises from the Company's investments in debt securities which are exposed to fluctuations in market prices, specifically in the current economically challenged market.

All other financial assets and liabilities are denominated in sterling and do not bear any exposure to currency risk.

Sensitivity analysis

Some results of sensitivity testing are set out below. For each sensitivity test the impact of a reasonably possible change in a single factor is shown, with other assumptions left unchanged.

Sensitivity factor

Description of sensitivity analysis

Interest rate and investment return

The impact of a change in market interest rates by $\pm 1\%$ (e.g. if a current interest rate is 5%, the impact of an immediate change to 4% or 6%).
The test allows consistently for similar changes to investment returns and movements in the market value of backing fixed interest securities.

Market prices

The impact of a change in market prices by $\pm 20\%$.

Expenses

The impact of an increase in ongoing administrative expenses and the claims handling expenses provision by 10%.

Loss ratios

The impact of an increase in loss ratios by 5%, which assumes no large losses triggering reinsurance recoveries.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3.3.1 Market risk (Continued)

Sensitivity at 31 December 2009

Impact on profit before tax (£'000)

	Market Prices +20%	Market Prices -20%	Interest rates +1%	Interest rates -1%	Expenses +10%	Loss ratio +5%
Gross of reinsurance	-	-	35	(35)	-	9
Net of reinsurance	-	-	35	(35)	-	9

Impact before tax on shareholders' equity (£'000)

	Market Prices +20%	Market Prices -20%	Interest rates +1%	Interest rates -1%	Expenses +10%	Loss ratio +5%
Gross of reinsurance	1,973 4	(1,973 4)	(91)	93	-	9
Net of reinsurance	1,973 4	(1,973 4)	(91)	93	-	9

Sensitivity at 31 December 2008

Impact on profit before tax (£'000)

	Market Prices +20%	Market Prices -20%	Interest rates +1%	Interest rates -1%	Expenses +10%	Loss ratio +5%
Gross of reinsurance	-	-	60	(60)	11	55
Net of reinsurance	-	-	60	(60)	11	55

Impact before tax on shareholders' equity (£'000)

	Market Prices +20%	Market Prices -20%	Interest rates +1%	Interest rates -1%	Expenses +10%	Loss ratio +5%
Gross of reinsurance	2,059 4	(2,059 4)	(102)	105	11	55
Net of reinsurance	2,059 4	(2,059 4)	(102)	105	11	55

Limitations of sensitivity analysis

The above tables show the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

3.3.2 Credit risk

Credit risk arises from the potential that losses are incurred from the failure of a counterparty to meet its credit obligations.

The objective of the Credit Risk Policy and supporting Minimum Standards is to document the control processes by which the Company is able to identify, monitor, measure, manage, control and mitigate the level of credit risk effectively against the risk appetite. The credit risk control environment is summarised below in the key elements of the policy.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)****3.3.2 Credit risk (Continued)****Credit risk governance**

A Credit Risk Management Framework must be in place that is appropriate for the agreed risk appetite that is established and maintained by adequately skilled credit risk professionals and is supported by appropriate minimum standards, tools, techniques and credit systems and reporting

Credit risk assessment and credit limit approvals

A credit risk assessment is a process to determine the credit worthiness of a counterparty prior to entering into a transaction or contract with that counterparty. A credit limit is used to define the level of credit risk that the Company is prepared to accept by a counterparty.

Where appropriate, the Company must assess credit risk and set a credit limit prior to entering into a transaction or contract with the counterparty. Each assessment and credit limit must be approved in accordance with Credit Authorities.

Credit authority

Credit risk assessments and limits must be approved by an individual or committee that has been provided with formally documented credit approval authority. Approval authorities must be reviewed and renewed at least annually.

Monitoring and reporting

Relevant business units must monitor the level of actual credit exposure and measure this against the defined credit assessments and limits.

The main sources of credit risk for the Company are as follows:

- investment counterparty - this arises from the investment of monies in the range of investment vehicles permitted by the Investment Policy,
- reinsurance recoveries - credit exposure to reinsurance counterparties arises in respect of reinsurance claims, and
- financing of premiums - loans made to customers in respect of deferred payments of their insurance premiums. These amounts are managed within the Credit Risk Management Framework and benefit from the Company's ability to cancel the underlying policy in the event of non-payment.

The Royal Bank of Scotland Group Risk Management sets standards for maintaining and developing credit risk management throughout the Group. This is achieved via a combination of governance structures, credit risk policies, control processes and infrastructure collectively known as the Group's Credit Risk Management Framework ("CRMF").

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3.3.2 Credit risk (Continued)

The following table provides information regarding the carrying value of financial and insurance assets that are neither past due nor impaired, the ageing of financial assets that are past due but not impaired and financial assets that have been impaired

At 31 December 2009

	Neither past due nor impaired £'000	Past due 1 - 30 days £'000	Past due 31 - 60 days £'000	Past due 61 - 90 days £'000	Past due more than 91 days £'000	Carrying value in the balance sheet £'000	Financial assets that have been impaired £'000
Debt securities (note 14)	9,867	-	-	-	-	9,867	-
Deposits with credit institutions (note 16)	1,367	-	-	-	-	1,367	-
Cash at bank and in hand (note 16)	84	-	-	-	-	84	-
Loans and receivables (note 15)	4	-	-	-	-	4	-
Total assets bearing credit risk	11,322	-	-	-	-	11,322	-

At 31 December 2008

	Neither past due nor impaired £'000	Past due 1 - 30 days £'000	Past due 31 - 60 days £'000	Past due 61 - 90 days £'000	Past due more than 91 days £'000	Carrying value in the balance sheet £'000	Financial assets that have been impaired £'000
Debt securities (note 14)	10,297	-	-	-	-	10,297	-
Deposits with credit institutions (note 16)	764	-	-	-	-	764	-
Cash at bank and in hand (note 16)	19	-	-	-	-	19	-
Loans and receivables (note 15)	2,414	-	-	-	-	2,414	575
Total assets bearing credit risk	13,494	-	-	-	-	13,494	575

The Company does not hold any collateral as security

There were no material financial assets that would have been past due or impaired had the terms not been renegotiated

The following table analyses the credit quality of financial and insurance assets that are neither past due nor impaired by type of asset. The table includes reinsurance exposure, after provision. Note 3.2.3 details the Company's approach to reinsurance credit risk management.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3.3.2 Credit risk (Continued)

At 31 December 2009

	AAA £'000	AA £'000	A £'000	BBB £'000	BB £'000	Not rated £'000	Total £'000
Debt securities (note 14)	5,346	3,529	992	-	-	-	9,867
Deposits with credit institutions (note 16)	-	-	1,367	-	-	-	1,367
Cash at bank and in hand (note 16)	-	84	-	-	-	-	84
Loans and receivables (note 15)	-	-	-	-	-	4	4
Total	5,346	3,613	2,359	-	-	4	11,322

At 31 December 2008

	AAA £'000	AA £'000	A £'000	BBB £'000	BB £'000	Not rated £'000	Total £'000
Debt securities (note 14)	3,294	2,535	4,468	-	-	-	10,297
Deposits with credit institutions (note 16)	-	764	-	-	-	-	764
Cash at bank and in hand (note 16)	-	19	-	-	-	-	19
Loans and receivables (note 15)	-	-	-	-	-	2,414	2,414
Total	3,294	3,318	4,468	-	-	2,414	13,494

Other loans and receivables due from policyholders, agents, brokers and intermediaries generally do not have a credit rating

3.3.3 Liquidity risk

Liquidity risk is the potential that obligations cannot be met as they fall due as a consequence of having a timing mismatch

The measurement and management of liquidity risk within the Company is undertaken within the limits and other policy parameters of the Company's liquidity risk appetite. It is included as part of the monthly Funds Management Committee pack and reviewed by the FMC. The asset class and maturity parameters contained within this policy are summarised above. Compliance is monitored both in respect of the internal policy and the regulatory requirements of the FSA.

The Company performs liquidity risk stress testing as part of its ICAS process. These tests are designed to assess the Company's liquidity requirement in order to meet claims and other liabilities in a number of different extreme event scenarios and compare this requirement against the liquidity available from its investment portfolio and other assets. In all of the events considered the Company is comfortably able to meet its liabilities as they fall due.

In the event that one or more liquidity stress or scenario crystallises, or should any other event that may impact liquidity occur, the company seeks to ensure that the event has rapid and controlled response. A Liquidity Crisis Management Team will be formed to assess the nature and the extent of the threat and to develop an appropriate response.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3.3.3 Liquidity risk (Continued)

Analysis of maturity of liabilities

For each category of insurance and financial liabilities, the following table shows the gross liability at 31 December 2009 analysed by remaining duration. The total liability is split by remaining duration in proportion to the cash-flows expected to arise during that period.

At 31 December 2009

	Total £'000	Within 1 year £'000	1 - 3 years £'000	3 - 5 years £'000	5-10 years £'000	Over 10 years £'000
Insurance liabilities (note 19)	92	70	22	-	-	-
Trade and other payables including insurance payables (note 20)	100	100	-	-	-	-
Total	192	170	22	-	-	-

At 31 December 2008

	Total £'000	Within 1 year £'000	1 - 3 years £'000	3 - 5 years £'000	5-10 years £'000	Over 10 years £'000
Insurance liabilities (note 19)	746	567	179	-	-	-
Trade and other payables including insurance payables (note 20)	3,058	3,058	-	-	-	-
Total	3,804	3,625	179	-	-	-

The above tables exclude unearned premium provisions as there are no liquidity risks inherent in them.

3.3.4 Concentration risk

Concentration risk arises when a number of counterparties are engaged in similar business activities or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions.

The distribution of the debt securities held across industry sectors was as follows:

	2009		2008	
	£'000	%	£'000	%
Finance	4,522	46%	7,003	68%
Government	5,345	54%	3,294	32%
	9,867	100%	10,297	100%

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009****3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)****3.3.5 Operational risk**

Effective operational risk management requires the Company to identify, assess, manage, monitor and report operational risk. Operational risk is inherent in all of the RBS Group's business processes, systems and products. Therefore, it is important to have a framework in place to ensure that operational risks are identified and managed to an acceptable level.

Effective operational risk management helps the Company to achieve its objectives, including

- more focus on doing things the right way, leading to fewer surprises,
- fewer operational errors and losses, leading to increased customer satisfaction and higher quality earnings,
- achieving process efficiencies,
- better informed risk-taking, which creates greater rewards, and
- increased management attention on the risks and issues that really matter

4 CAPITAL RISK MANAGEMENT

The Company defines capital in accordance with regulations prescribed by the Financial Services Authority (FSA) and manages it in accordance with the RBS Insurance Capital Management Policy. Its objectives when managing capital are

- to comply with legal and regulatory obligations and maintain capital resources commensurate with the nature, scale and risk profile of its business,
- to provide a framework for monitoring the capital position of the Company, including the procedures to be followed during periods of general financial stress, either due to internal or external events, and
- to safeguard its ability to continue as a going concern

Under the rules prescribed by the FSA, the Company must at all times maintain assets of a value sufficient to cover its liabilities, including liabilities arising under or in connection with contracts of insurance and that there is a suitable matching of assets and liabilities.

The FSA rules require the Company to maintain a surplus of admissible assets over its liabilities which is at all times at least equal to the higher of its Minimum Capital Requirement (MCR) or its Individual Capital Guidance (ICG).

The MCR is a formulaic approach, prescribed by the EU, based on business volumes and claims reserves, whereas the ICG is specified by the FSA following the bi-annual submission of a risk-based capital assessment (in accordance with the Individual Capital Adequacy Standards) by the Company to the regulator.

As at 31 December 2009, the Company held a surplus of at least £7,600,000 (2008: £6,500,000) above its MCR requirement of £3,128,000 (2008: £2,518,000).

Management information to monitor the Company's capital requirements and solvency position is produced and presented to the RBS Insurance Capital Committee and the Company Board on a regular basis ensuring that the Company meets its capital requirements at all times.

The Company has complied with the FSA imposed rules and guidance in respect of capital in both 2009 and 2008.

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**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**
5 NET INSURANCE PREMIUM REVENUE

	2009 £'000	2008 £'000
Premium income from insurance contracts issued		
Premium receivables	179	(103)
Change in unearned premium provision	4	1,211
Net insurance premium revenue	<u>183</u>	<u>1,108</u>

6 INVESTMENT INCOME

	2009 £'000	2008 £'000
Available-for-sale financial assets		
Interest income from debt securities	322	463
Interest income		
From deposits with credit institutions	4	71
Net amortisation of discount on purchase of financial assets	(37)	(9)
	<u>289</u>	<u>525</u>

7 OTHER OPERATING INCOME

	2009 £'000	2008 £'000
Reversal of provision for impairment of receivables from policyholders	<u>741</u>	<u>-</u>

8 INSURANCE CLAIMS AND LOSS ADJUSTMENT EXPENSES

	2009		
	Gross £'000	Reinsurance £'000	Net £'000
Current accident year claims paid	47	-	47
Prior accident years' claims paid	374	(11)	363
Movement in current accident year claims provision	-	-	-
Movement in prior accident years' claims provision	(653)	-	(653)
	<u>(232)</u>	<u>(11)</u>	<u>(243)</u>

	2008		
	Gross £'000	Reinsurance £'000	Net £'000
Current accident year claims paid	407	-	407
Prior accident years' claims paid	1,271	17	1,288
Movement in current accident year claims provision	88	-	88
Movement in prior accident years' claims provision	(1,683)	-	(1,683)
	<u>83</u>	<u>17</u>	<u>100</u>

Loss adjustment expenses for the year of £7,680 (2008 £80,403) have been included in the accident year figures above

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

9 EXPENSES

	2009 £'000	2008 £'000
a) Commission expenses		
Cost incurred for the acquisition of insurance contracts expensed in the year	<u>(13)</u>	<u>1,413</u>

	2009 £'000	2008 £'000
b) Expenses for marketing and administration		
Marketing and administration expenses	(11)	30
Net foreign exchange translation losses	<u>5</u>	<u>-</u>
	<u>(6)</u>	<u>30</u>

10 TAXATION

	2009 £'000	2008 £'000
Current taxation		
Tax charge for the period	412	25
Under provision in respect of prior periods	<u>17</u>	<u>108</u>
Tax charge for the period	<u>429</u>	<u>133</u>

The actual tax charge differs from the expected tax charge computed by applying the standard rate of UK corporation tax of 28% (2008 28.5%) as follows

	2009 £'000	2008 £'000
Expected tax charge	412	25
Effects of		
Adjustments in respect of prior years	<u>17</u>	<u>108</u>
Tax charge	<u>429</u>	<u>133</u>

The aggregate current and deferred tax relating to items that are charged to other comprehensive income is £21,000 (2008 £33,000)

11 PROFIT/(LOSS) FOR THE YEAR

Auditors' remuneration

Fees for audit and non-audit services, included within marketing and administration expenses, are borne and recharged by a related party, RBS Insurance Services Limited

Fees paid to the auditors with respect to the statutory audit of the Company amount to £9,000 (2008 £8,500)

Other services fees in respect of the audit of the FSA Return amount to £5,000 in 2009 (2008 £5,000)

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

11 PROFIT/(LOSS) FOR THE YEAR (Continued)

Fees paid to directors during the year amounted to £nil (2008 £nil)

No directors who served during this or the previous financial year were remunerated by the Company. The amounts disclosed above are those relating to their services as directors for the Company based on an estimated time allocation basis. Emoluments in relation to services performed by the directors for other group companies are not disclosed in the Company's financial statements.

Emoluments, excluding pension contributions, paid to the highest paid director amounted to £nil (2008 £nil)

A contribution of £nil (2008 £nil) to a defined pension scheme was made on behalf of the highest paid director. No directors (2008 no directors) had retirement benefits accruing under defined pension schemes in respect of qualifying service, no directors (2008 no directors) had benefits accruing under money purchase pension schemes.

During the year no directors have exercised options (2008 none)

12 DEFERRED ACQUISITION COSTS

	2009 £'000	2008 £'000
At 1 January	-	1,187
Net charge to statement of comprehensive income	-	(1,187)
At 31 December	-	-

13 CLASSIFICATION OF FINANCIAL INSTRUMENTS

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 in note 1 describes how the classes of financial instrument are measured and how income and expenses of the financial assets and liabilities by category are defined in IAS39 and by the balance sheet heading.

At 31 December 2009

	Available for-sale £'000	Loans and receivables £'000	Other (amortised costs) £'000	Non- financial assets/ liabilities £'000	Total £'000
Prepayments and accrued income	-	-	n/a	30	30
Financial investments	9,867	-	n/a	-	9,867
Loans and receivables	-	4	n/a	-	4
Cash and cash equivalents	-	1,451	n/a	-	1,451
	<u>9,867</u>	<u>1,455</u>	<u>-</u>	<u>30</u>	<u>11,352</u>
Insurance liabilities	n/a	n/a	-	92	92
Trade and other payables including insurance payables	n/a	n/a	100	-	100
Current tax liabilities	n/a	n/a	-	405	405
	<u>-</u>	<u>-</u>	<u>100</u>	<u>497</u>	<u>597</u>
Equity					10,755
					<u><u>11,352</u></u>

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

13 CLASSIFICATION OF FINANCIAL INSTRUMENTS (Continued)

At 31 December 2008

	Available for-sale £'000	Loans and receivables £'000	Other (amortised costs) £'000	Non- financial assets/ liabilities £'000	Total £'000
Financial investments	10,297	-	n/a	-	10,297
Loans and receivables	-	2,414	n/a	-	2,414
Cash and cash equivalents	-	783	n/a	-	783
	<u>10,297</u>	<u>3,197</u>	<u>-</u>	<u>-</u>	<u>13,494</u>
Insurance liabilities	n/a	n/a	-	749	749
Trade and other payables including insurance payables	n/a	n/a	3,058	-	3,058
Current tax liabilities	n/a	n/a	-	36	36
	<u>-</u>	<u>-</u>	<u>3,058</u>	<u>785</u>	<u>3,843</u>
Equity					9,651
					<u>13,494</u>

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

14 FINANCIAL INVESTMENTS

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 in note 1 describes how the classes of financial instrument are measured and how income and expenses of the financial assets and liabilities by category are defined in IAS39 and by the balance sheet heading.

	2009 £'000	2008 £'000
Available-for-sale investments		
Debt securities		
Listed - fixed interest rate	6,384	4,334
Listed - floating interest rate	3,483	5,963
	<u>9,867</u>	<u>10,297</u>

Included within the debt securities balance above is £5,345,000 (2008: £3,300,000) placed with related parties, as analysed in note 22.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy.

At 31 December 2009

Notes	Level 1 (note 1) £'000	Level 2 (note 2) £'000	Level 3 (note 3) £'000	Total £'000	Sensitivity Analysis	
					Low £'000	High £'000
Available-for-sale financial assets						
Debt securities	<u>5,345</u>	<u>4,522</u>	<u>-</u>	<u>9,867</u>	<u>-</u>	<u>-</u>

At 31 December 2008

Notes	Level 1 (note 1) £'000	Level 2 (note 2) £'000	Level 3 (note 3) £'000	Total £'000	Sensitivity Analysis	
					Low £'000	High £'000
Available-for-sale financial assets						
Debt securities	<u>3,294</u>	<u>7,003</u>	<u>-</u>	<u>10,297</u>	<u>-</u>	<u>-</u>

There were no transfers between Level 1 and Level 2 during the year.

1 Included in the Level 1 category are financial assets that are measured in whole or in part by reference to published quotes in an active market. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis.

2 Included in the Level 2 category are financial assets measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions. These are assets and liabilities for which pricing is obtained via pricing services, but where prices have not been determined in an active market, financial assets with fair values based on broker quotes, investments in private equity funds with fair values obtained via fund managers and assets that are valued using the Group's own models whereby the majority of assumptions are market observable.

3 Included in the Level 3 category are financial assets measured using non-market observable inputs. This means that fair values are determined in whole or in part using a valuation technique (model) based on assumptions that are neither supported by prices from observable current market transactions in the same instrument nor are they based on available market data. The main asset classes in this category are unlisted equity investments and debt securities. Valuation techniques are used to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, that is, an exit price from the perspective of the Group. Therefore, unobservable inputs reflect the Group's own assumptions about the assumptions that market participants would use in pricing the asset (including assumptions about risk). These inputs are developed based on the best information available, which might include the Group's own data.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

14 FINANCIAL INVESTMENTS (Continued)

Reconciliation of movements in Level 3 financial instruments measured at fair value

There were no Level 3 financial instruments in 2008 and 2009

15 LOANS AND RECEIVABLES

	2009 £'000	2008 £'000
Receivables arising from insurance and reinsurance contracts		
Due from agents, brokers and intermediaries	4	2,848
Less provision for impairment of receivables from policyholders	-	(575)
Due from reinsurers		
Receivables from related parties (note 22)	-	119
Other debtors	-	22
Total loans and receivables including insurance receivables	4	2,414

16 CASH AND CASH EQUIVALENTS

	2009 £'000	2008 £'000
Cash at bank and in hand		
- related parties (note 22)	84	19
Short-term deposits with credit institutions		
- related parties (note 22)	1,367	764
	1,451	783

The effective interest rate on short term deposits with credit institutions was 0.40% (2008 1.75%) and has an average maturity of two days

For the purposes of the cash flow statement, cash and cash equivalents are as follows

	2009 £'000	2008 £'000
Cash and cash equivalents	1,451	783

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**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**
17 SHARE CAPITAL

	2009 £'000	2008 £'000
Authorised		
Equity shares		
50 million ordinary shares of £1 each	<u>50,000</u>	<u>50,000</u>
Issued and fully paid		
Equity shares		
14.9 million (2008: 14.9 million) ordinary shares of £1 each	<u>14,900</u>	<u>14,900</u>
At 1 January and 31 December		

18 OTHER RESERVES AND RETAINED LOSSES

	2009 £'000	2008 £'000
Other reserves at 31 December	<u>143</u>	<u>85</u>
Retained losses at 31 December	<u>(4,288)</u>	<u>(5,334)</u>

Movements in the revaluation reserve for available-for-sale investments were as follows

	2009 £'000	2008 £'000
At 1 January	85	4
Revaluation during the period - gross	79	114
Revaluation during the period - taxation	(21)	(33)
At 31 December	<u>143</u>	<u>85</u>

19 INSURANCE CONTRACTS AND REINSURANCE ASSETS

	2009 £'000	2008 £'000
Gross		
Claims reported	42	567
Claims incurred but not reported	50	179
Unearned premiums	-	3
Total insurance liabilities, gross	<u>92</u>	<u>749</u>
Net		
Claims reported	42	567
Claims incurred but not reported	50	179
Unearned premiums	-	3
Total insurance liabilities, net	<u>92</u>	<u>749</u>

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NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

19 INSURANCE CONTRACTS AND REINSURANCE ASSETS (Continued)

Insurance claims - gross										
Accident year	2001 £'000	2002 £'000	2003 £'000	2004 £'000	2005 £'000	2006 £'000	2007 £'000	2008 £'000	2009 £'000	Total £'000
Estimate of ultimate claims costs										
At end of accident year	592	1,526	9,778	14,821	13,758	12,856	3,482	445	47	57,305
One year later	158 (22)	212 (380)	(867) 2,556	(12) 1,614	(452) 823	(892) 25	(40) 2	137	-	(1,776) 4,618
Two years later	-	(29)	169	(1,151)	(62)	(354)	-	-	-	(1,427)
Three years later	-	7	13	(36)	(97)	-	-	-	-	(113)
Four years later	-	6	(388)	14	-	-	-	-	-	(368)
Five years later	-	500	8	-	-	-	-	-	-	508
Six years later	-	-	-	-	-	-	-	-	-	-
Seven years later	-	-	-	-	-	-	-	-	-	-
Eight years later	-	-	-	-	-	-	-	-	-	-
Current estimate of cumulative claims	728	1,842	11,249	15,250	13,970	11,635	3,444	582	47	58,747
Cumulative payments to date	(728)	(1,842)	(11,241)	(15,241)	(13,970)	(11,611)	(3,393)	(582)	(47)	(58,655)
Liability recognised in balance sheet	-	-	8	9	-	24	51	-	-	92
Liability in respect of prior years	-	-	-	-	-	-	-	-	-	-
Loss adjustment expenses	-	-	-	-	-	-	-	-	-	-
Total liability included in the balance sheet										
Insurance claims - net of reinsurance										
Accident year	2001 £'000	2002 £'000	2003 £'000	2004 £'000	2005 £'000	2006 £'000	2007 £'000	2008 £'000	2009 £'000	Total £'000
Estimate of ultimate claims costs										
At end of accident year	602	1,008	7,661	11,784	11,114	10,352	2,854	445	47	45,867
One year later	88	200	(524)	74	(476)	(842)	(40)	137	-	(1,383)
Two years later	(22)	(380)	2,069	1,272	343	25	2	-	-	3,309
Three years later	-	(29)	136	(958)	(62)	(354)	-	-	-	(1,267)
Four years later	-	7	9	(36)	(97)	-	-	-	-	(117)
Five years later	-	6	(388)	14	-	-	-	-	-	(368)
Six years later	-	500	8	-	-	-	-	-	-	508
Seven years later	-	-	-	-	-	-	-	-	-	-
Eight years later	-	-	-	-	-	-	-	-	-	-
Current estimate of cumulative claims	688	1,312	8,971	12,150	10,822	9,181	2,816	582	47	46,549
Cumulative payments to date	(688)	(1,312)	(8,963)	(12,141)	(10,822)	(9,157)	(2,765)	(582)	(47)	(46,457)
Liability recognised in balance sheet	-	-	8	9	-	24	51	-	-	92
Liability in respect of prior years	-	-	-	-	-	-	-	-	-	-
Loss adjustment expenses	-	-	-	-	-	-	-	-	-	-
Total liability included in the balance sheet										

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

19 INSURANCE CONTRACTS AND REINSURANCE ASSETS (Continued)

Movements in insurance liabilities and reinsurance assets

(i) Claims and loss adjustment expenses

	Gross £'000	Reinsurance £'000	Net £'000
Notified claims	1,421	-	1,421
Incurred but not reported	486	-	486
At 1 January 2008	1,907	-	1,907
Cash paid for claims settled in the year	(1,678)	(17)	(1,695)
Increase in liabilities			
- arising from current year claims	495	-	495
- arising from prior year claims	22	17	39
At 31 December 2008	746	-	746
Notified claims	567	-	567
Incurred but not reported	179	-	179
At 1 January 2009	746	-	746
Cash paid for claims settled in the year	(422)	11	(411)
Increase in liabilities			
- arising from current year claims	47	-	47
- arising from prior year claims	(279)	(11)	(290)
At 31 December 2009	92	-	92
Notified claims	42	-	42
Incurred but not reported	50	-	50
At 31 December 2009	92	-	92

(ii) Provisions for unearned premiums and unexpired short term insurance risks

	Gross £'000	Reinsurance £'000	Net £'000
Unearned premium provision			
At 1 January 2008	1,214	-	1,214
Net decrease in the year	(1,211)	-	(1,211)
At 31 December 2008	3	-	3
Net decrease in the year	(3)	-	(3)
At 31 December 2009	-	-	-

20 TRADE AND OTHER PAYABLES INCLUDING INSURANCE PAYABLES

	2009 £'000	2008 £'000
Due to reinsurers		
- third party reinsurers	-	11
Due to related parties (note 22)	22	-
Trade creditors and accruals	71	3,047
Other creditors	7	-
	100	3,058

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

21 CONTINGENT LIABILITIES

There are no contingent liabilities that require disclosure in these financial statements

22 RELATED PARTIES

On 1 December 2008, the UK Government through HM Treasury became the ultimate controlling party of The Royal Bank of Scotland Group plc. The UK Government's shareholding is managed by UK Financial Investments Limited, a company wholly owned by the UK Government. As a result, the UK Government and UK Government controlled bodies became related parties of the Company.

The Company's ultimate holding company is The Royal Bank of Scotland Group plc which is incorporated in Great Britain and registered in Scotland. Its immediate parent company is RBS Insurance Group Limited which is incorporated in Great Britain and registered in England and Wales.

As at 31 December 2009, The Royal Bank of Scotland Group plc heads the largest and smallest group in which the Company is consolidated. Copies of the consolidated accounts of The Royal Bank of Scotland Group plc may be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh EH12 1HQ.

The volume and diversity of transactions with government related entities are such that their disclosure of their amounts during the year are impractical.

The following transactions were carried out with related parties, who are all members of The Royal Bank of Scotland plc.

i Purchases of products and services	2009	2008
	£'000	£'000
Purchases of services		
RBS Insurance Services Limited	22	81

Purchases of services also includes payments made between companies determined by the levels of business generated and as agreed between the parties on an arm's length basis.

All employees were employed by RBS Insurance Services Limited, a fellow subsidiary company. Total employee costs, including directors' remuneration, recharged to the Company by RBS Insurance Services Limited during the year were £930 (2008: £77,000).

Employee costs recharged by RBS Insurance Services Limited includes the full costs of key managers and other staff in respect of share-based payments. The attribution among members of the RBS Group has regard to the needs of the group as a whole.

ii Compensation of key management

Key management personnel were remunerated by another Group company in 2009. No recharge of remuneration costs to the Company occurred in either 2008 nor 2009.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

22 RELATED PARTIES (Continued)

iii Year-end balances arising from sales/purchases of products/services

	2009	2008
	£'000	£'000

Bank deposits held with related parties (note 16)

National Westminster Bank Plc

1,451	783
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	2009	2008
	£'000	£'000

Debt securities held with related parties (note 14)

UK Government

5,345	3,300
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	2009	2008
	£'000	£'000

Receivables from related parties (note 15)

Inter Group Insurance Services Limited

RBS Insurance Services Limited

-	100
-	19
-	119

	2009	2008
	£'000	£'000

Movements in receivables from related parties were as follows

At 1 January	119	-
Transactions in the year	-	1,369
Settled in the year	(119)	(1,250)
At 31 December	-	119

Due to related parties (note 20)

	2009	2008
	£'000	£'000

Due to other related parties

RBS Insurance Services Limited

22	-
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	2009	2008
	£'000	£'000

Movements due to related parties were as follows

At 1 January	-	399
Transactions in the year	22	81
Settled in the year	-	(480)
At 31 December	22	-

iv Tax

	2009	2008
	£'000	£'000

Current tax liabilities are payable as follows

HM Revenue & Customs

405	36
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