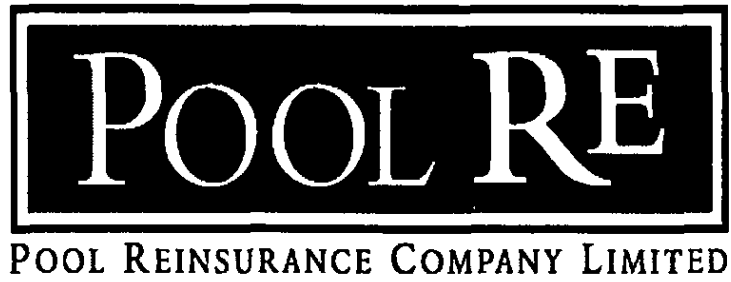


2798901



## ANNUAL REPORT 2011

WEDNESDAY



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COMPANIES HOUSE

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## CHAIRMAN'S STATEMENT

The Company's profit after tax for 2011 was £364.9 million, and the accumulated balance on the profit and loss account available to meet future claims increased to £4,313.8 million at 31 December 2011. Gross premium income increased from £308.2 million to £324.7 million this year.

The level of profit represents another year of positive trading by the Company which has, in turn, contributed to the growth in the assets of the firm.

The total investment fund value at 31 December 2011 was £4.47 billion. For the year as a whole a return of 2.0% was achieved. This was behind the rate of RPI inflation, which was 4.8% for the year.

The continuing low interest rate environment had a major impact on investment returns. In addition, the ongoing crisis in the Eurozone resulted in increased volatility in risk assets (such as equities and commodities) and corporate bonds. Of equal concern was the increased risk associated with sovereign debt. Credit rating downgrades and the loss of the prized AAA rating by the US, along with France and Austria more recently, served only to aggravate the situation.

During 2011, there continued to be a threat of a terrorist attack in the UK. The threat level published by the Home Office was changed in July 2011 to "substantial" which means that an attack is considered to be a strong possibility. There were, however, no incidents giving rise to claims in 2011 and thankfully this remains the case at the date of this statement. The Company's investment policy continued to be based on the premise that our assets will be managed against the contingency that they could be required to meet a claim or series of claims at any time, while recognising that they may not be called upon for long periods.

During the course of 2011 the Company worked to enhance further the plans it has in place to deal with major events and also commissioned a new claims financial management system. The technical team continued its programme of review meetings, working closely with Members to ensure that there is a high level of compliance with the Scheme rules and readiness to deal with any claims that might arise under the Scheme, including those involving a chemical, biological, radiological or nuclear dimension. The results of these visits to Members together with any matters arising were reported to the Board at its regular meetings. In addition to these reviews, the technical team continued to provide general assistance to Members by responding to their queries on the operation of the Scheme. The annual analysis of Exposure Data confirmed that there remains a high degree of fairness in the way that the Scheme operates across the membership.

The Company continued to meet regularly with HM Treasury to discuss matters arising in relation to the operation of the Scheme.

The change in the role of the FSA and the transition to the "twin peaks" regulatory model was, and will continue to be, the subject of detailed consideration by the Company. In addition, we continued to keep a close eye on changes in law and regulation applicable to the Company. Part of this exercise was the annual consideration by the Board of the Company's position in relation to Chapter 1 of the Competition Act 1998. As explained in my previous statements, it is necessary for the Company to assess on an ongoing basis whether the Scheme continues to meet the exemption requirements set out in that Act. Following a review in June 2011 the Board concluded that, based upon the facts known to the Board and legal advice obtained, the exemption requirements continue to be met.

The number of Members fell slightly during the year, and there has not been any material change in this position since the year end. At 31 December 2011 the membership totalled 239 (2010: 255).

Reinsurance rates charged to Members were again unchanged during the year. However, Members should be aware that rates may be changed at any time should circumstances require.

There has been only one change to the composition of the Board since my last report and that is the addition of Andrew Skirton who brings to the Board a wealth of experience in the investment arena, having formerly been Co-Chief Executive Officer of Barclays Global Investors and Non-Executive Chairman of Gartmore Investment Management. We extend a very warm welcome to him.

I should like to draw your attention to the separate statement on corporate governance which is to be found on pages 9 to 11.

The notice of our Annual General Meeting will be sent to Members in a separate circular and I hope that many of you will be able to attend. In addition to participating in the formal business of the Company it is a great opportunity for Members to meet the Directors face to face, as well as the executive management team and staff.

Finally, I would like to thank all the Members for their continuing support of the Scheme and those individuals who give their time to serve on our Advisory Committee. My thanks also go to the Company's directors, executives and staff for all their work during the year.

A handwritten signature in black ink, appearing to read 'Tony Latham', written in a cursive style.

**Tony Latham**

Chairman

22 March 2012

## THE BOARD

Details of the current Directors of the Company are set out below

### **Anthony P Latham ACII#**

*Chairman*

Aged 61 A Director since May 1996 and appointed Chairman in June 2003 Previously Group Director, Global Relationships, RSA Insurance Group PLC Chairman of Pool Reinsurance (Nuclear) Limited Deputy Chairman of Codan A/S and Codan Forsikring A/S Non-executive Director of Ecclesiastical Insurance Group PLC, Ecclesiastical Insurance Office PLC, Flagstone Reinsurance Holdings S A and Torus Insurance (UK) Limited

### **Roderick D Armitage Barrister FCIS**

Aged 68 A Director since August 2003 Former Head of Company Affairs at the Confederation of British Industry and former non-executive Director of Centre for Effective Dispute Resolution Limited Previously Legal Director and Company Secretary at Staveley Industries PLC

### **Inga K Beale ACII**

Aged 48 A Director since January 2011 Appointed Group Chief Executive Officer of Canopus Group in December 2011 Ms Beale held senior positions in Zurich Financial Services Group between 2008 and 2011, including Global Chief Underwriting Officer from 2009 She was Group Chief Executive Officer of Converium Limited between 2006 and 2007

### **Peter J Box CA#**

Aged 59 A Director since February 2010 Former audit and business advisory partner at PricewaterhouseCoopers Director, Chairman of the Audit Committee and member of the Remuneration Committee of Marsh Limited Director and Chairman of the Risk and Audit Committee of the Family Assurance Friendly Society Limited Trustee of the Royal Flying Doctors Service of Australia, Friends in the UK

### **Alan J Brown FSIP#**

Aged 58 A Director since July 2008 Group Chief Investment Officer and Director of Schroders PLC Chairman of the Carbon Disclosure Project and Director of the Investment Management Association (IMA) IMA alternate member of the Takeover Panel Chairman and Treasurer of Centre for Economic Research and Graduate Education – Economics Institute (CERGE-EI US Foundation) Chairman of MSCI Barra Editorial Advisory Board

### **Graham V Doswell FCII#**

Aged 66 A Director since January 2002 Former Group Chief Executive of Ecclesiastical Insurance Group PLC Chairman of MMA Insurance PLC Director of Pool Reinsurance (Nuclear) Limited, Provident Insurance PLC and Swinton Group Limited

### **Brian J G Hilton CB\***

Aged 71 A Director since January 2001 Former Director General of the Department of Trade and Industry Director of Pool Reinsurance (Nuclear) Limited and Scor Insurance (UK) Limited Chairman of Governors of the Royal Agricultural College

### **Andrew G Skirton #**

Aged 48 A Director from December 2011 Non-executive Chairman of Gartmore Group Limited between 2007 and 2011, and Co-Global Chief Executive Officer of Barclays Global Investors between 2002 and 2006

### **Andrew Torrance**

Aged 58 A Director since December 2010 Chief Executive of Allianz Insurance plc since 2003 and former Chief Executive of London & Edinburgh Insurance Group plc

# Member of the Investment Committee

\* Mr Hilton was appointed as a Director by HM Government, in accordance with the Articles of Association of the Company

## **EXECUTIVE MANAGEMENT**

Chief Executive                      Stephen A Atkins FCII MCS1 MCMI

Chief Financial Officer              Peter N Aves ACA

General Counsel and  
Company Secretary                  Helen L Chapman, Solicitor

Head of Market Operations        Andrew M Cockhill ACII

Chief Investment Officer            Ian M Coulman

## **CORPORATE INFORMATION**

Registered in                        England, United Kingdom

Registration number                2798901

Registered office                  Hanover House, 14 Hanover Square, London W1S 1HP, United Kingdom

Telephone number                + 44 (0) 20 7337 7170

Facsimile number                + 44 (0) 20 7337 7171

E-mail                                enquiries@poolre.co.uk

Website                              www.poolre.co.uk

## **REPORT OF THE DIRECTORS**

The Directors of Pool Reinsurance Company Limited (registered number 2798901) present their report and the audited financial statements of the Company for the year ended 31 December 2011

## **STATUS OF THE COMPANY**

The Company is a private company limited by guarantee, not having a share capital.

The Company is authorised by the Financial Services Authority

The Company is not part of a group. It does not have any branches outside the United Kingdom. It does not have subsidiary undertakings.

## **PRINCIPAL ACTIVITY**

During the year under review and since the year end there was no change in the principal activity of the Company which continued to be reinsurance business conducted on a mutual basis. The Directors do not anticipate that the nature of the Company's business will change in the future.

The Company provides reinsurance in respect of losses arising from damage to or destruction of commercial property resulting from Acts of Terrorism (as defined in the Reinsurance (Acts of Terrorism) Act 1993) within England, Wales and Scotland. The Company has a Retrocession Agreement with HM Government under the terms of which HM Government will make funds available in circumstances where the Company's assets are insufficient to meet all claims.

## **BUSINESS REVIEW**

### **Review of the Business**

A review of the business of the Company, including an analysis of the development and performance of the Company, particulars of any other significant events that occurred during the year, and the position of the Company at the year end can be found in the Chairman's statement on page 2. Given the purpose for which the Company was formed, its business is unlikely to change in the future. The unpredictability of terrorist events means that the Company is not in a position to make statements regarding likely future developments.

### **Management of Risk**

The Company has developed policies for identifying, assessing, measuring, monitoring and controlling risk. These policies are established, approved and reviewed at least annually by the Board and updated as and when appropriate.

The risks faced by the Company are considered under a number of categories, such categories correspond to certain categories of risk referred to in the FSA's Prudential Sourcebook for Insurers, namely Insurance Risk, Credit Risk, Market Risk (which includes Investment Risk), Liquidity Risk and Operational Risk.

### **Principal Risks and Control Measures**

The Directors consider that the principal risks which face the Company are in the areas of Insurance Risk, Investment Risk and Operational Risk. Descriptions of the principal risks together with details of the control measures adopted by the Company are as follows -

- **Insurance Risk** – this risk arises from the unpredictability of the timing, frequency and severity of insured events. Significant controls are in place to ensure, to the extent possible, that liquid funds are available to meet claims or series of claims as and when necessary. In addition, there is no limit on the indemnity provided by HM Government under the terms of the Retrocession Agreement.
- **Investment Risk** – the Company is exposed to a range of financial risks through its financial assets including its investments. These risks, the overall financial and investment risk management objective and the use of financial instruments by the Company are described in note 1 to the financial statements on page 22.

- **Operational Risk** – the risk of a problem with the operation of the Pool Re Scheme. Significant resource is dedicated to identifying, assessing and managing operational risks on an ongoing basis. The Company's position in relation to competition law is set out in the Chairman's statement.

The Company has adopted Risk Policies to address the management of its financial and non-financial risks. There are procedures in place to identify, assess and manage the risks faced by the Company.

### **Key Performance Indicators**

The Company has considered the key performance indicators necessary for an understanding of its business. A profile of the Company's membership is set out on page 32. The level of participation in the Scheme is a factor by which the position of the Company's business can be measured. Taking account of the other information provided in this report and notes to the financial statements, and in view of the special nature of the Company, there are no additional key performance indicators that are considered necessary for an understanding of the Company's business. There are no environmental or employee matters for which key performance indicators are necessary for an understanding of the business of the Company.

## **RESULTS**

The Company made a profit after taxation of £364.9 million for the year ended 31 December 2011. £281.2 million was transferred from the general business technical account and there were investment expenses, interest and bank facility charges of £6.4 million. Investment income amounted to £237.4 million, including realised investment profits of £116.1 million. Unrealised investment losses were £153.1 million. The amount allowed for taxation was a credit of £5.7 million.

Taxation relates to the United Kingdom corporation tax on investment income receivable and realised and unrealised profits, less interest payable and investment expenses. There is no taxation on the underwriting result as the business is conducted on a mutual basis.

Subject to the terms of the Retrocession Agreement made between the Company and HM Government dated 30 July 1993 as amended, the Company would draw funds from HM Government if claims were to exceed the Company's resources. The Agreement specifies circumstances in which amounts paid by HM Government will be subject to repayment by the Company. However, in certain circumstances, when the Agreement is terminated, HM Government is not entitled to repayment of amounts it has paid to the Company. The Directors have determined that, so long as these existing contractual arrangements apply, the Company will take credit, when assessing the adequacy of the technical provisions, for anticipated recoveries in respect of any deficit in those technical provisions.

## **DIRECTORS**

All the Directors serve in a non-executive capacity. Copies of the Directors' service contracts are available for inspection at the Company's registered office.

The Directors who served during the year were

A P Latham (Chairman)  
 R D Armitage  
 I K Beale (appointed 24 January 2011)  
 P J Box  
 A J Brown  
 G V Doswell  
 B J G Hilton  
 A G Skirton (appointed 19 December 2011)  
 D A Torrance

Brief biographical details of the Directors in office at the date of this report can be found on page 4.

In accordance with the Articles of Association of the Company, Mr Skirton will seek election at the Annual General Meeting. In addition, Mr Armitage and Mr Box will retire by rotation and seek re-election, and Mr Latham and Mr Doswell, each having served as a Director for more than nine years, will offer themselves for re-election at that meeting.



The Company does not have any share capital and, accordingly, the Directors do not have any relevant interests that require disclosure

#### **DIRECTORS' INDEMNITIES**

The Company has entered into indemnities for the benefit of its existing Directors and future Directors, and these indemnities remained in force as at the date of this report. Copies of the Directors' indemnities, which are qualifying indemnity provisions, are available for inspection at the Company's registered office

#### **FINANCIAL INSTRUMENTS**

The Company's financial risk management objectives and policies with regard to the use of financial instruments are described in note 1 on page 22

#### **DONATIONS**

In the year under review the Company made no donations for political or charitable purposes (2010: £nil)

#### **DIVIDEND**

The Articles of Association of the Company do not provide for any distribution to be made to the Members except in the circumstances of a winding up

#### **DISCLOSURE OF INFORMATION TO INDEPENDENT AUDITORS**

At the date of this report, each individual Director states that he/she is not aware of any relevant audit information of which the Company's auditors are unaware, and each individual Director states that he/she has taken the steps he/she ought to have taken as set out in section 418(4) of the Companies Act 2006 as a Director to make himself/herself aware of any relevant audit information and establish whether the Company's auditors were aware of that information

#### **INDEPENDENT AUDITORS**

PricewaterhouseCoopers LLP have confirmed their willingness to continue in office as auditors to the Company and a resolution to reappoint PricewaterhouseCoopers LLP as auditors to the Company will be proposed at the Annual General Meeting

By Order of the Board



**Helen L Chapman**  
General Counsel and Company Secretary  
22 March 2012

## STATEMENT ON CORPORATE GOVERNANCE

### Introduction

The Board's policy is to maintain a framework of corporate governance that would be considered good practice in companies of similar significance. Therefore, although the Company is not required to comply with the UK Corporate Governance Code and certain other codes and guidelines as it is not listed, the Board considers their provisions in determining the Company's own corporate governance arrangements, which are described below. The Company is not required to prepare a statement on its compliance with corporate governance guidelines. However, the Board of Directors considers that it is appropriate to make a statement about the Company's corporate governance arrangements.

### Directors

The Board consists solely of non-executive Directors, including a non-executive Chairman. Brief biographical details are set out on page 4.

In accordance with the terms of the Articles of Association, one Director may be appointed and removed from office by HM Government. With the exception of this Director, the appointment of any new Director is considered by the Board. In accordance with the provisions of the Articles of Association, any Directors appointed by the Board must retire at the first Annual General Meeting following their appointment, and a number nearest to one third of the other Directors, excluding the Director appointed by HM Government, must retire by rotation each year.

The composition of the Board is considered at appropriate intervals to ensure an appropriate balance of expertise and experience relevant to the Company's needs. The need for a new Director and the profile of the individual are agreed by the Board as a whole. Equal consideration is given to all suitable candidates irrespective of gender, race or any other demographic factor.

The Board considers annually the ongoing independence of each Director, taking into account the period they have served, whether they are also directors of companies within groups that cede business to Pool Re or whether they have been appointed by significant counterparties. The Board has determined that, as at the date of this statement, all of its Directors continue to be independent in character and judgement.

### Role of the Board

The Board is responsible for the overall strategy of the Company, its values and standards, its management performance and all major business decisions. There is a formal schedule of matters reserved to the Board, which is reviewed annually. The Board has delegated to its committees and to the executive management the power to make decisions on operational matters within a framework of internal control procedures. The appointment and removal of the Chief Executive and the General Counsel and Company Secretary are matters reserved to the Board.

The Board meets at least four times in each year. The financial performance of the Company is reviewed at each meeting and the Board calendar details standing items and matters for periodic review.

The table below sets out each Director's attendance at the meetings of the Board they were eligible to attend during 2011.

	<u>Number of meetings attended</u>	<u>Number of meetings held</u>
A P Latham	4	4
R D Armitage	4	4
I K Beale	4	4
A J Brown	4	4
P J Box	4	4
G V Doswell	3	4
B J Hilton	2	4
D A Torrance	4	4

Each year the Board undertakes an evaluation of its performance, including assessing the performance of the Chairman, Chief Executive and Investment Committee. For 2011, the Board appointed external board performance consultants to conduct the

evaluation. This assessment involved interviews with each of the Directors individually, as well as the Chief Executive, the General Counsel and Company Secretary, and the Chief Financial Officer, culminating in a report to the Board as a whole. The next externally facilitated evaluation is planned to be undertaken in 2014, with the evaluations for the intervening years being carried out in accordance with an internal procedure.

The respective roles and responsibilities of the Chairman and the Chief Executive are set out in writing in the Board Procedures Manual.

The Chairman, in conjunction with the General Counsel and Company Secretary, ensures that the Board receives the information it needs in order to discharge its responsibilities. All Directors have access to the services of the General Counsel and Company Secretary and independent professional advice is available to the Directors in respect of any issue arising in the course of their duties, at the expense of the Company. New Directors are given an induction and training for Directors is provided as is deemed appropriate.

## **Committees**

The Board has established four standing Committees, being the Investment Committee, the Admissions Committee, the Advisory Committee and the Conflicts of Interest Committee.

The role of the Investment Committee is to consider the Company's investment matters and, where appropriate, it undertakes actions in accordance with the powers delegated to it, or makes recommendations to the Board. The Investment Committee is made up of the Chief Executive and those Directors who are noted to be members in the biographical details on page 4. The Investment Committee meets at least four times per year and is chaired by the Chairman.

The role of the Admissions Committee is to consider and approve the admission of prospective members to the Company and to authorise the execution of the relevant documents. The members of the Admissions Committee are the Chairman, the Chief Executive and the General Counsel and Company Secretary, but any of the Directors may serve on the Committee in their absence. The Admissions Committee meets as and when required to consider applications for Membership.

The role of the Advisory Committee is to consider and provide advice to the Board on matters concerning the operational aspects of the Scheme, both current and prospective. The Advisory Committee's membership reflects its statement of aims, which has been approved by the Board.

The role of the Conflicts of Interest Committee is to consider and authorise situations where a Director's interests may conflict with the interests of the Company. The members of the Conflicts of Interest Committee are the Chairman and any one other Director (or where the matter to be considered relates to the Chairman, another Director will serve in his place), who act in consultation with the Chief Executive. The membership is flexible to ensure that members do not consider matters relating to themselves. The Conflicts of Interest Committee meets as and when necessary.

In addition to the above committees, the Board may from time to time establish ad hoc committees to address any specific purpose, with such delegation of powers and membership as the Board considers appropriate or necessary to meet its aims.

In accordance with the Articles of Association the proceedings of any Committee to which the Board has delegated powers are minuted and reported to the Directors at the next following Board meeting.

## **Directors' and Executive Remuneration**

The Company's Articles of Association provide that until otherwise determined by ordinary resolution there shall be paid to the Directors such fees as the Directors determine not exceeding an annual aggregate of £250,000. Members approved an increase in the annual aggregate limit applicable to Directors' fees to £350,000 at the Annual General Meeting held in 2011. Subject to the annual aggregate limit, Directors receive fees at levels approved by the Board.

The Board reviews Directors' and executive remuneration levels on an annual basis, and incorporates the use of market data to do so. Directors serving on the Investment Committee receive additional fees to reflect the additional time commitment involved. No Director receives any additional remuneration from the Company other than his or her fees. Directors are not paid compensation for loss of office.

### **Independent Auditors**

The Board's policy on the provision of non-audit services to the Company by the auditors is that they are permitted to perform such work in areas where it is appropriate for them to do so, and provided that this does not compromise their independence

### **Statement of Going Concern**

The Board is satisfied, after taking account of the Retrocession Agreement with HM Government, that the Company has adequate financial resources to continue to operate for the foreseeable future and is financially sound. For this reason, it considers the going concern basis appropriate for the preparation of financial statements

### **Internal Control**

The Board has the responsibility for establishing systems of internal control to safeguard both the Members' and the Company's assets and to ensure compliance with laws and regulations. The Board reviews and keeps updated a risk and control assessment framework and has established a process for the regular review of that framework. Reviews covering (i) the effectiveness of the Company's system of internal controls and (ii) its risk management are carried out by external providers on a regular basis. A report including recommendations and management responses in respect of each review has been considered by the Board

By Order of the Board



**Helen L Chapman**  
General Counsel and Company Secretary  
22 March 2012

## **STATEMENT OF DIRECTORS' RESPONSIBILITIES**

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements,
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006.

## **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF POOL REINSURANCE COMPANY LIMITED**

We have audited the financial statements of Pool Reinsurance Company Limited for the year ended 31 December 2011 which comprise the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

### **Respective Responsibilities of Directors and Auditors**

As explained more fully in the Directors' Responsibilities Statement set out on page 12, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

### **Scope of the Audit of the Financial Statements**

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

### **Opinion on Financial Statements**

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2011 and of its profit and cash flows for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006

### **Opinion on Other Matter 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

*Marcus Hine*

**Marcus Hine (Senior Statutory Auditor)**  
For and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London

22 March 2012

## PROFIT AND LOSS ACCOUNT

Technical account - General business  
for the 12 months to 31 December 2011

		<u>2011</u>	<u>2010</u>
	Notes	£'000	£'000
Gross premiums written		324,672	308,195
Outwards reinsurance premiums	13	(32,467)	(30,820)
<b>Net premiums written</b>		<u>292,205</u>	<u>277,375</u>
Change in the gross provision for unearned premiums		(7,342)	2,747
Change in the provision for unearned premiums, reinsurers' share		734	(275)
<b>Earned premiums, net of reinsurance</b>		<u>285,597</u>	<u>279,847</u>
<b>Claims incurred, net of reinsurance</b>			
Claims paid			
- gross amount		-	(128)
Change in provision for claims			
- gross amount		-	128
<b>Claims incurred, net of reinsurance</b>		<u>-</u>	<u>-</u>
Net operating expenses	2	(4,368)	(3,637)
<b>Balance on the technical account for general business</b>		<u>281,229</u>	<u>276,210</u>

The above results all relate to continuing operations and to risks located in the United Kingdom

Pages 18 to 31 form an integral part of these financial statements  
The independent auditors' report is on page 13

## PROFIT AND LOSS ACCOUNT

Non-technical account  
for the 12 months to 31 December 2011

	Notes	2011 £'000	2010 £'000
<b>Balance on the technical account for general business</b>		281,229	276,210
Investment income			
Income from financial assets at fair value through profit and loss		121,352	120,894
Net gains on realisation of investments		116,064	52,325
Investment income		<u>237,416</u>	<u>173,219</u>
Net unrealised (losses) / gains on investments		(153,128)	29,548
Investment expenses and charges	3	(6,350)	(4,974)
<b>Profit on ordinary activities before tax</b>		359,167	474,003
Tax on profit on ordinary activities	8	5,694	(39,364)
<b>Profit for the financial year</b>		<u>364,861</u>	<u>434,639</u>

The above results all relate to continuing operations

There were no recognised gains and losses other than as stated in the Profit and Loss Account, and accordingly no statement of recognised gains and losses is presented

### Note of historical profits and losses

Neither gains/losses of an insurance company arising on the holding or disposal of investments, nor the effect of fair value accounting for financial instruments are required to be included in a note of historical profits and losses. There are no other differences between the profit on ordinary activities before tax or the profit for the financial year stated above and their historical cost equivalents

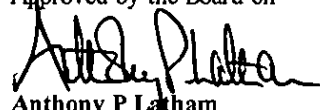
Pages 18 to 31 form an integral part of these financial statements  
The independent auditors' report is on page 13




**BALANCE SHEET**  
as at 31 December 2011

	Notes	2011 £'000	2011 £'000	2010 £'000	2010 £'000
<b>ASSETS</b>					
<b>Investments</b>					
Other financial investments	9		4,468,539		4,118,623
<b>Reinsurers' share of technical provisions</b>					
Provision for unearned premiums			15,198		14,463
<b>Debtors</b>					
Debtors arising out of reinsurance operations		69,614		64,792	
Other debtors	12	<u>7,008</u>		<u>21</u>	
			76,622		64,813
<b>Other assets</b>					
Tangible assets	10	34		68	
Cash at bank and in hand	11	<u>7,735</u>		<u>15,126</u>	
			7,769		15,194
<b>Prepayments and accrued income</b>					
Accrued interest		49,277		42,900	
Other prepayments		<u>235</u>		<u>234</u>	
			49,512		43,134
<b>Total assets</b>			<u>4,617,640</u>		<u>4,256,227</u>
<b>LIABILITIES</b>					
<b>Capital and reserves</b>					
Profit and loss account	17		4,313,781		3,948,920
<b>Financial liabilities</b>					
Other financial investments	9		32,943		18,627
<b>Technical provisions</b>					
Provision for unearned premiums		151,976		144,634	
Claims outstanding		<u>7,114</u>		<u>7,114</u>	
			159,090		151,748
<b>Provisions for other risks and charges</b>	13		76,086		94,573
<b>Creditors</b>					
Creditors arising out of reinsurance operations		34,557		37,091	
Other creditors including taxation	12	-		4,040	
<b>Accruals and deferred income</b>		<u>1,183</u>		<u>1,228</u>	
			35,740		42,359
<b>Total liabilities</b>			<u>4,617,640</u>		<u>4,256,227</u>

Approved by the Board on 22 March 2012 and signed on its behalf by

  
Anthony P Latham  
Director

  
Peter J Box  
Director

Pages 18 to 31 form an integral part of these financial statements  
The independent auditors' report is on page 13

**CASH FLOW STATEMENT**  
for the 12 months to 31 December 2011

	Notes	<u>2011</u> <u>£'000</u>	<u>2010</u> <u>£'000</u>
<b>Operating activities</b>			
Net cash inflow from operating activities	14	389,802	380,710
<b>Taxation</b>			
Tax paid		(24,530)	(36,884)
<b>Net cash inflow</b>	15	<u>365,272</u>	<u>343,826</u>
Cash flows were invested as follows			
<b>Portfolio investments</b>			
Shares and other variable yield securities and units in unit trusts		30,196	(12,909)
Debt securities and other fixed interest securities		329,465	705,334
Deposits with credit institutions		25,323	(357,115)
Other (including derivative instruments)		<u>(12,321)</u>	<u>(5,281)</u>
Net portfolio investments		372,663	330,029
<b>(Decrease)/increase in cash holdings</b>		(7,391)	13,797
<b>Net investment of cash flows</b>	15	<u>365,272</u>	<u>343,826</u>

The above results all relate to continuing operations

Pages 18 to 31 form an integral part of these financial statements.  
The independent auditors' report is on page 13

## STATEMENT OF ACCOUNTING POLICIES

### *Basis of Preparation*

The financial statements have been prepared in accordance with the provisions of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI2008/410") relating to insurance companies and with the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers ("the ABI SORP") dated December 2005, as amended in December 2006

The financial statements have been prepared in accordance with applicable accounting standards in the United Kingdom. A summary of the more important accounting policies of the Company is set out below

### *Changes in Accounting Policies*

No changes have been made to the Company's accounting policies during the current financial year

### *Insurance Business*

The Company's financial position and its obligations to meet claims under its agreements with Members are assured in that the Company has entered into a Retrocession Agreement with HM Government under which the Company would draw funds from HM Government if claims were to exceed the Company's resources. The Agreement specifies circumstances in which amounts paid by HM Government will be subject to repayment by the Company. However, in certain circumstances when the agreement is terminated, HM Government is not entitled to repayment of amounts it has paid to the Company

The premium due to HM Government for providing retrocession cover becomes payable only when the funds standing to the credit of the Insurance Fund and the Investment Fund, as defined by the Retrocession Agreement, exceed £1 billion. These accumulated funds exceeded £1 billion at 31 December 2011. These funds are broadly equivalent to premiums received, investment income earned and investment gains, less investment losses, incurred claims, taxation and expenses, subject to certain differences in the timing of their recognition. The retrocession premium may become immediately payable, in certain circumstances, if the Company fails to comply with the conditions of the Retrocession Agreement

### *Insurance Contracts*

The Company has reviewed the nature of the inwards and outwards reinsurance business it transacts. It is satisfied that all such business falls within the definition of Insurance Risk as defined in FRS 26 and has therefore treated the relevant contracts as insurance contracts for the purposes of these financial statements

### *Basis of Accounting*

#### **(a) General insurance business accounting**

##### **(i) Technical results**

The technical results are determined using the annual basis of accounting whereby the incurred costs of claims and expenses are charged against the earned proportion of premiums, net of reinsurance

##### **(ii) Premiums written**

Premiums written relate to business that inceptioned during the year, together with any difference between booked premiums for prior years and those previously accrued, and include estimates of premiums due but not yet receivable or notified to the Company

##### **(iii) Unearned premiums**

Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date, calculated on a time apportionment basis

**(iv) Claims incurred**

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

**(v) Claims provisions and reinsurance recoveries**

Provision is made at the year end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the Company. The Company takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

In estimating the cost of claims notified but not paid, the Company has regard to the cost of claims incurred by Members, both within and in excess of each Member's retention. The overall emerged claims cost is closely managed by the Company.

The nature of the underlying business is such that there is no significant delay between the occurrence of a claim and the claim being reported. However, there can be significant delays in assessing the Company's ultimate liability for such claims. Claims notified to the Company at the balance sheet date are estimated on a basis that reflects the current position for Members' liabilities to their policyholders, less Members' retentions.

Provisions are calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts that may be recoverable from reinsurers based upon the gross provisions and having due regard to collectability.

**(vi) Outwards reinsurance premiums**

Provision is made for outwards reinsurance premiums payable to HM Government under the terms of the Retrocession Agreement.

**(b) Expenses**

Capital expenditure on computer equipment and office equipment is depreciated by equal instalments over the estimated useful lives of the assets. Expenditure on computer software is written off as incurred.

All expenses, other than investment expenses, are charged to the technical account.

**(c) Investment income and other investment movements**

Investment income, which is all included in the non-technical account, is determined on an accruals basis. Realised gains or losses represent the difference between net sales proceeds and the purchase price. Movements in unrealised gains and losses on investments represent the difference between the fair value at the balance sheet date and purchase price or, if previously valued, the fair value at the previous balance sheet date.

Adjustments are made in respect of investments realised during the year where unrealised gains or losses were previously recognised in the Profit and Loss Account.

Dividends are recorded on the date on which the shares are quoted ex-dividend.

**(d) Financial assets**

Other Financial Investments are accounted for at fair value through the Profit and Loss Account. Fair value estimation is discussed further in note 9.

The fair values of quoted investments are based on bid prices other than short positions which are based on offer prices at the balance sheet date. For unquoted investments the Company establishes fair value by using valuation techniques. These include reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models.

Purchases and sales of financial assets are accounted for as at trade date.

The carrying values of Debtors, Prepayments and Accrued Income are assumed to approximate to their fair values due to the short-term nature of the assets

**(e) Financial liabilities**

The Company has creditors which it recognises as financial liabilities. These are recognised at fair value. The Company also has derivatives which it recognises as financial liabilities when valued at a loss at year end.

The carrying values of Creditors, Accruals and Deferred Income are assumed to approximate to their fair values due to the short-term nature of the liabilities.

**(f) Derivative financial instruments**

Derivatives are recognised at fair value at the date on which the contract is entered into and any subsequent changes in fair value are recognised immediately in the Profit and Loss Account. Fair values are obtained from various sources. Market prices, including recent market transactions, are used in valuing quoted instruments. In valuing unquoted instruments, valuation techniques, including discounted cash flow models and options pricing models, are used as appropriate. Pricing model valuations are derived mainly using observable data, for example, underlying interest rates, foreign exchange rates or market volatility.

**(g) Tangible assets**

Tangible assets are stated at historical purchase cost less accumulated depreciation. Depreciation is calculated to write off the costs of tangible assets, less their residual values, over their expected useful lives using the straight line basis. Furniture and fixtures are depreciated over five years and computer and telephone equipment over two years.

**(h) Cash at bank and in hand**

Cash at bank and in hand includes deposits held at call with banks.

**(i) Taxation**

Taxation is charged on investment income receivable and realised and unrealised gains, less interest payable and investment expenses, for the period.

**(j) Deferred tax**

Deferred tax is recognised in respect of all material timing differences that have originated but not reversed at the balance sheet date, where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date, including revaluation gains and losses on investments recognised in the Profit and Loss Account.

A net deferred tax asset is recognised as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which to recover carried forward tax losses and from which the future reversal of underlying timing differences can be deducted.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on an undiscounted basis.

**(k) Operating leases**

Rents payable under operating leases are charged to the Profit and Loss Account as incurred over the lease term.

**(1) Foreign currency translation**

Items included in the financial statements of the Company are measured in UK pounds Sterling

Foreign currency transactions are translated into UK pounds Sterling using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Profit and Loss Account for the period.

Translation differences on non-monetary items, such as equities held at fair value through the Profit and Loss Account, are reported as part of the fair value gain or loss.

## NOTES TO THE FINANCIAL STATEMENTS

### 1. *Management of Financial Risk*

The overall financial risk management objective is to invest the Company's assets against the contingency that they may be required in the short term to deal with a claim or series of claims, but with recognition that they may not be called upon for long periods

The Company has adopted risk policies to address the management of its investment risks and there are procedures in place to identify, assess and manage the risks faced by the Company

The Board has set an investment strategy and has employed a number of independent investment managers under specific mandates to administer the Company's investments. In addition, the Company has an Investment Committee which considers all aspects of the Company's investment activity and, where appropriate, makes recommendations to the Board

The agreed investment strategy rests on the two main objectives for the fund of stability and liquidity, with the asset allocation aligned to these. Two stability risk measures and two liquidity risk measures have been adopted and risk budgets have been agreed in respect of each measure

The investment portfolio is diversified and the investment policy sets limits on the Company's exposure to various types of investment. There is a formal process to review regularly and, where appropriate, rebalance the asset allocation towards the benchmark

Reports on investment performance are considered at the quarterly Investment Committee meetings and as a standing item in the Company's quarterly Board meetings. Contact is maintained throughout the year with each investment manager and the custodian and reports are received on a monthly basis from each of them. The Company meets regularly with the investment managers and the custodian and there is a process for considering and resolving any operational issues which arise

Derivative contracts are used by the Company only for the purposes of efficient portfolio management. Hence, derivatives are used to reduce risk, to reduce cost or to generate additional capital or income at no, or an acceptably low, level of risk

The Company is exposed to a range of financial risks through its financial assets, financial liabilities and policyholder liabilities, the most important of which are market (equity price, interest rate and currency), credit, liquidity and cash flow risk

#### **(a) Market Risk**

##### **(i) Equity price risk**

The Company is exposed to equity price risk as a result of changes in the value of its holdings in equity investments which are included within its financial assets at fair value. At the year end the Company held £672m (2010 £617m) in shares and other variable-yield securities and units in unit trusts, including commodities unit trusts. This comprised 15.0% (2010 15.0%) of the total financial investments

In order to mitigate its exposure to the risk of changes in the prices of individual equities, the Company has a broadly diversified portfolio of both UK and overseas equities which are managed on a passive basis against well established market indices. For 2011 the benchmark weighting for UK equity holdings was set at 25% of the equity element of the fund and the remainder was spread across a number of overseas markets

A 30% change in the value of equities and commodities at the year end would have resulted in a movement in Profit before tax of £202m (2010 £185m). Since this sensitivity was measured using the actual values at the year end, no assumptions have been made for this calculation. In addition there have been no changes in the method of calculation from the previous year

#### **(ii) Interest rate risk**

The Company is exposed to interest rate risk which arises primarily from investments in fixed interest securities. The Company uses certain derivatives to mitigate this interest rate risk. Investments in derivatives are governed by specific provisions within the investment mandates and can only be made for the purposes of efficient portfolio management.

Modified duration has been used as the measure of the sensitivity to changes in interest rates of the Company's fixed interest portfolio. Modified duration is the weighted average of the duration of each holding in the portfolio taking account of the key characteristics of coupon, maturity and cash flows. Since September 2011 a long gilt futures contract has been used to reduce modified duration in the portfolio. At 31 December 2011 the average modified duration of the fixed interest portfolio, including index-linked government bonds, without taking account of the gilt futures was 2.01 years (2010 2.25 years). The effect of the gilt futures was to reduce the fixed interest portfolio average modified duration to 1.31 years.

#### **(iii) Currency risk**

The Company is exposed to currency risk in respect of investments denominated in a currency other than Sterling. The Company's policy is to hedge a proportion of the non-Sterling denominated investments back into Sterling through the use of forward contracts. At the end of the year the value of unhedged assets denominated in currencies other than Sterling within the portfolios was £243m (2010 £273m).

A 25% change in the value of Sterling at the year end against the mix of currencies within the Company's investment fund, after taking account of hedged positions, would have resulted in a movement in the Profit before tax of approximately £61m (2010 £68m). Since this sensitivity was measured using the actual values at the year end, no assumptions have been required for this calculation. In addition there have been no changes in the method of calculation from the previous year.

#### **(b) Credit Risk**

Credit risk arises from the failure of a counterparty to perform its financial obligations or a failure to perform those obligations in a timely manner. The Company's investment policies are designed to restrict the level of credit risk in the fund by setting limits on individual investments or groups of investments. Such limits are set by reference to the credit ratings determined by established credit rating agencies and individual issuer limits.

The total exposure of the investment fund to credit risk at the year end was £3,789m (2010 £3,303m), representing the total value of bonds, bank deposits and commercial paper. Of this total, 72% (2010 86%) was invested in UK Government Gilts and other AAA/AA rated securities. A full analysis is set out below.



	December 2011 £m	December 2010 £m
Debt securities	3,724	3,274
Cash and cash equivalents	58	20
Undertaking for collective investments	14	13
Other (including derivatives)	(7)	(4)
<b>Total assets bearing credit risk</b>	<b>3,789</b>	<b>3,303</b>
	%	%
AAA (including UK gilts)	57	80
AA	15	6
A	22	8
BBB	4	3
Below BBB or not rated	-	1
A-1+	1	-
A-1	1	1
A-2	-	1
<b>Total assets bearing credit risk</b>	<b>100</b>	<b>100</b>

At the balance sheet date, excluding UK Government Gilts and US Government Securities, the maximum credit risk exposure to a single counterparty amounted to less than 5% of the Net Asset Value (2010 less than 5%)

The Company receives reports from its investment managers detailing any breaches of mandates including those resulting from defaults and past due items. No financial assets of material value were past due or impaired at the year end.

With regard to the credit risk associated with the debtors arising from reinsurance operations, all material balances outstanding at the year end were fully paid by the end of February 2012.

### (c) Liquidity Risk

As stated above, the Company's overall financial risk management objective is to invest the assets against the contingency that they may be required in the short term to deal with a claim or series of claims, but with recognition that they may not be called upon for long periods. In respect of short term liquidity, the benchmark investment portfolio provides for 65% of the Company's total investment assets to be self-liquidating within 18 months, comprising bonds with maturities of less than 18 months. At 31 December 2011, 64% (2010 62%) of the Company's investment assets were held in bonds with maturities of less than 18 months.

The Company has financial liabilities shown on the face of the Balance Sheet in respect of creditors and foreign exchange derivatives. The table below is a maturity analysis of the Company's financial liabilities. Cash flows in respect of derivative liabilities are shown on an undiscounted basis.

	Within 1 year	
	2011 £m	2010 £m
<b>As at 31 December</b>		
Other creditors	-	4
Derivatives	25	15
	<u>25</u>	<u>19</u>

**(d) Cash Flow Risk**

In view of the nature of the Company's assets and its contractual arrangements with HM Government, cash flow risk is not considered to be significant

**2 Net Operating Expenses**

The Company's net operating expenses consisted of administrative expenses of £4,368k (2010 £3,637k)

**3 Investment Expenses and Charges**

	<u>2011</u> £'000	<u>2010</u> £'000
Investment expenses and charges comprised		
Investment management and other charges	(3,552)	(2,276)
Interest payable on outwards reinsurance		
Less than one year	(921)	(834)
Greater than one year	(1,877)	(1,864)
	<u>(6,350)</u>	<u>(4,974)</u>

**4 Operating Lease Rentals**

	<u>2011</u> £'000	<u>2010</u> £'000
Operating lease rentals payable for the year		
Land and buildings	90	94
Plant and machinery	1	4
	<u>91</u>	<u>98</u>

Annual commitments in respect of non-cancellable operating leases (excluding VAT) are as follows

	<u>2011</u> £'000	<u>2010</u> £'000
Operating leases which expire between 1 and 5 years		
Land and buildings	80	80
Other	3	3
	<u>83</u>	<u>83</u>

Operating lease rentals for land and buildings are in respect of buildings only

**5 Employee Information**

The average number of persons employed on a full time equivalent basis by the Company during the year was 12 (2010 - 11)

	<u>2011</u> £'000	<u>2010</u> £'000
Staff costs for these persons were		
Wages and salaries	1,628	1,402
Social security costs	207	170
	<u>1,835</u>	<u>1,572</u>

## 6 Directors' Emoluments

The aggregate emoluments payable to certain Directors of the Company as individuals for the year were £227,949 (2010 £174,668). In addition £22,000 (2010 £20,479) was paid to third parties for making available the services of the other Directors. The total emoluments paid to the Company's highest paid Director for the year were £66,000 (2010 £55,875).

## 7 Auditors' Remuneration

Profit on Ordinary Activities Before Tax is stated after charging fees for auditors' remuneration in respect of the audit of the financial statements for the year of £63,750 (2010 £63,750) excluding VAT and fees in respect of non audit services pursuant to local legislation of £21,250 (2010 £21,250) excluding VAT. Other fees payable to PricewaterhouseCoopers LLP in respect of the year amounted to £75,000 (2010 £52,000) excluding VAT for taxation work.

## 8 Tax on Profit on Ordinary Activities

	2011 £'000	2010 £'000
Tax on profit on ordinary activities comprised		
United Kingdom Corporation Tax		
Current tax on income for the period at 26.5% (2010 - 28%)	(22,763)	(29,402)
Adjustments in respect of prior periods	9,262	8,697
<b>Total current tax</b>	<b>(13,501)</b>	<b>(20,705)</b>
Deferred tax - origination and reversal of timing differences at 25% (2010 - 27%)	19,195	(18,659)
<b>Tax on profit on ordinary activities</b>	<b>5,694</b>	<b>(39,364)</b>

### Factors affecting the tax charge for the period

The tax assessed for the year is different from the standard rate of UK Corporation Tax 26.5%. The differences are explained below.

	2011 £'000	2010 £'000
<b>Non-technical account</b>		
<b>Profit on ordinary activities before tax</b>	<b>359,167</b>	<b>474,003</b>
Corporation Tax at the standard UK rate of 26.5% (2010 28%) on Profit on Ordinary Activities	(95,179)	(132,721)
Adjustments for non-taxable items Tax at 26.5% (2010 28%) on		
Technical income	74,526	77,339
Dividend income	3,453	3,057
Other investment expenses, capital allowances and bank charges	135	125
Investment gains and losses on equities	(16,122)	22,798
Investment gains on index linked government bonds	10,424	-
Adjustments in respect of prior periods	9,262	8,697
<b>Total current tax charge for the period</b>	<b>(13,501)</b>	<b>(20,705)</b>

## 9 Other Financial Investments

	<u>2011</u> £'000	<u>2010</u> £'000
Other financial investments comprised		
<b>Financial Assets</b>		
Shares and other variable-yield securities and units in unit trusts	672,135	616,800
Debt securities and other fixed income securities	3,713,895	3,476,491
Deposits with credit institutions	58,683	19,512
Other (including derivative instruments)	23,826	5,820
	<u>4,468,539</u>	<u>4,118,623</u>
<b>Financial Liabilities</b>		
Other (including derivative instruments)	<u>(32,943)</u>	<u>(18,627)</u>

All financial investments are accounted for at fair value with the movement in fair value passed through the Profit and Loss Account

Issuers of shares and other variable-yield securities, debt securities and other fixed income securities, apart from government-issued securities, are listed on recognised exchanges. As at 31 December 2011 the purchase cost of shares and other variable-yield securities was £616,605k (2010 £494,661k), the purchase cost of debt securities and other fixed income securities was £3,632,535k (2010 £3,312,787k) and premiums received in respect of options written amounted to £nil (2010 £6k)

The table below shows fair values of derivative contracts outstanding at the year end

		<u>Fair value</u> <u>2011</u> £'000	<u>Fair value</u> <u>2010</u> £'000
Foreign exchange contracts	Assets	12,463	5,590
	Liabilities	<u>(25,107)</u>	<u>(15,147)</u>
		(12,644)	(9,557)
Options	Liabilities	-	(26)
		<u>(12,644)</u>	<u>(9,583)</u>

The table below shows the contract/notional amounts of derivative contracts held at the year end

	<u>Contract/notional amount</u> <u>2011</u>			<u>Contract/notional amount</u> <u>2010</u>		
	Asset £'000	Liability £'000	Net £'000	Asset £'000	Liability £'000	Net £'000
Foreign exchange contracts	2,011,161	(2,011,161)	-	1,476,372	(1,476,372)	-
Gilt futures contracts	-	(321,613)	(321,613)	-	-	-

In respect of gilt futures contracts, the value of initial margin at the year end was £321,613k. The margin is provided in the form of government-issued securities held within the Company's investment fund and the Company retained beneficial ownership. The Company also keeps cash aside to satisfy any call with the Company being entitled to those cash balances and to the interest due on them. Variation margin payments are made or received by the Company daily. Hence gilt futures contracts have £nil fair value outstanding at the year end.

## Fair Value Estimation

For financial instruments held at fair value, the Company discloses fair value measurements by level of the following fair value measurement hierarchy

**Level 1** - Quoted prices (unadjusted) in active markets for identical assets or liabilities

**Level 2** - Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices)

**Level 3** – Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs)

The following table shows the Company's financial assets and financial liabilities measured at fair value

	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
<b>As at 31 December 2011</b>				
Shares and other variable-yield securities and units in unit trusts	490	170	12	672
Debt securities and other fixed income securities	1,673	2,011	30	3,714
Derivatives	(13)	-	-	(13)
	<u>2,150</u>	<u>2,181</u>	<u>42</u>	<u>4,373</u>
<b>As at 31 December 2010</b>				
Shares and other variable-yield securities and units in unit trusts	440	175	2	617
Debt securities and other fixed income securities	1,768	1,679	29	3,476
Derivatives	(10)	-	-	(10)
	<u>2,198</u>	<u>1,854</u>	<u>31</u>	<u>4,083</u>

The fair value of financial instruments traded in active markets is based on quoted bid prices at the balance sheet date as described in the Basis of Accounting on page 18. These instruments are included in Level 1, and at the year end comprised mainly government bonds (including index linked government bonds).

Where it is determined that there is no active market, fair value is established using a valuation technique. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2. At the year end Level 2 securities comprised mainly corporate bonds and bonds from non UK government agencies. Prices for these securities are taken mainly from vendor sources and have been evaluated using a consensus pricing method.

If one or more of the significant inputs is not based on observable market data, the instrument is included in Level 3. Less than 1% of the Company's financial instruments were included in Level 3 at the year end.

The following table shows the changes in Level 3 instruments in the year

	<u>2011</u>	<u>2010</u>
	<u>£m</u>	<u>£m</u>
Level 3 instruments at 1 January	31	14
Transfer into Level 3	8	-
Changes in market value	(4)	-
Purchases during the year	36	30
Disposals during the year	(29)	(13)
<b>Level 3 instruments at 31 December</b>	<b><u>42</u></b>	<b><u>31</u></b>

# **10 Tangible Assets**

	Computer & telephone equipment £000	Furniture & fixtures £000	Total £000
<u>Book Cost</u>			
At 1 January 2011	36	185	221
Additions	-	-	-
Disposals	-	-	-
<b>At 31 December 2011</b>	<b><u>36</u></b>	<b><u>185</u></b>	<b><u>221</u></b>
<u>Depreciation</u>			
At 1 January 2011	36	117	153
Charge for the period	-	34	34
Disposals	-	-	-
<b>At 31 December 2011</b>	<b><u>36</u></b>	<b><u>151</u></b>	<b><u>187</u></b>
<u>Net Book Value</u>			
<b>At 31 December 2011</b>	<b><u>-</u></b>	<b><u>34</u></b>	<b><u>34</u></b>
At 31 December 2010	<u>-</u>	<u>68</u>	<u>68</u>

# **11 Cash at bank and in hand**

	<u>2011</u>	<u>2010</u>
	<u>£'000</u>	<u>£'000</u>
Cash at bank and in hand	<u>7,735</u>	<u>15,126</u>

The average interest rate earned by the Company on Cash at Bank and in Hand was 0.06% (2010: 0.13%)

**12 Other Debtors and Creditors including Taxation**

	<u>2011</u>	<u>2010</u>
	<u>£'000</u>	<u>£'000</u>
Other debtors comprised		
Current taxation	6,988	-
Other debtors	20	21
	<u>7,008</u>	<u>21</u>
Other creditors comprised		
Current taxation	<u>-</u>	<u>4,040</u>

Creditors were all current and payable within 12 months

**13 Provisions for Other Risks and Charges**

	Deferred tax	Outwards reinsurance premiums	Total
	<u>£'000</u>	<u>£'000</u>	<u>£'000</u>
Provisions for other risks and charges comprised			
At 1 January 2011	29,473	65,100	94,573
Utilised in the year	-	(34,557)	(34,557)
Interest movement	-	2,798	2,798
Profit and Loss Account (credit)/charge	(19,195)	32,467	13,272
<b>At 31 December 2011</b>	<u>10,278</u>	<u>65,808</u>	<u>76,086</u>

In accordance with FRS 19 a provision has been made for a deferred tax liability arising from timing differences. As at 31 December 2011 there was a recognised deferred tax liability of £10,278k in respect of unrealised gains on equities.

**14 Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities**

	<u>2011</u>	<u>2010</u>
	<u>£'000</u>	<u>£'000</u>
Profit on ordinary activities before tax	359,167	474,003
Depreciation	34	34
Gains on realisation of investments	(116,064)	(52,325)
Unrealised losses/(gains) on investments	153,128	(29,548)
(Increase)/decrease in debtors excluding tax	(4,821)	655
Increase in prepayments and accrued income	(6,378)	(3,753)
(Increase)/decrease in reinsurers' share of technical provisions	(735)	275
Increase/(decrease) in technical provisions	7,342	(2,874)
Decrease in creditors excluding tax	(2,579)	(2,351)
Increase/(decrease) in provisions for risks and charges excluding deferred tax	708	(3,406)
<b>Net cash inflow from operating activities</b>	<u>389,802</u>	<u>380,710</u>

## 15 Cash Flows

	2011 £'000	2011 £'000	2010 £'000	2010 £'000
Cash flows were invested as follows.				
(Decrease)/increase in cash holdings		(7,391)		13,797
Purchases of shares and other variable-yield securities and units in unit trusts	589,384		403,217	
Sales of shares and other variable-yield securities and units in unit trusts	(559,188)		(416,126)	
Purchases of debt securities and other fixed income securities	3,401,633		3,209,700	
Sales of debt securities and other fixed income securities	(3,072,168)		(2,504,366)	
Net increase/(decrease) in deposits with credit institutions	25,323		(357,115)	
Net decrease in other (including derivative instruments)	(12,321)		(5,281)	
Net portfolio investments for the period		372,663		330,029
Net investment of cash flows		<u>365,272</u>		<u>343,826</u>

## 16 Movements in Net Portfolio Investments

	2011 £'000	2010 £'000
Net portfolio investments at 1 January	4,099,997	3,688,095
Net portfolio investments for the period	372,663	330,029
Changes in market values and exchange rate effects	(37,064)	81,873
Net portfolio investments at 31 December	<u>4,435,596</u>	<u>4,099,997</u>

## 17 Movements in the Profit and Loss Account

	2011 £'000	2010 £'000
Profit and Loss Account at 1 January	3,948,920	3,514,281
Profit for the financial year	364,861	434,639
Profit and Loss Account at 31 December	<u>4,313,781</u>	<u>3,948,920</u>

## 18 Floating Charge over the Company's Assets

On 7 September 1993 the Company executed a debenture deed granting HM Government a floating charge over the Company's assets. The terms of that charge restrict the Company from creating further charges without the consent of HM Government. The floating charge crystallises and takes effect as a fixed charge in the event, inter alia, of default by the Company in meeting certain of its obligations to HM Government, and upon termination of the Retrocession Agreement.

## 19 Capital Resources

The Company falls within the exclusion in Article 1 (2)(d) of EU Directive 2005/68/EC (Reinsurance Directive). The Financial Services Authority made, on application of the Company, a direction in January 2007 under section 148 of the Financial Services and Markets Act 2000 which was renewed on identical terms in July 2011. The effect of the direction is that, inter alia, the Company's capital resources requirement is zero and it is not required to hold equalisation provisions.



# Members' Profile

as at 31 December 2011

	Number of Members	Percentage of Members	Number of Votes	Percentage of Votes
<b><u>Analysis by Jurisdiction</u></b>				
Austria	1	0.4%	1	0.0%
Belgium	2	0.8%	77	2.3%
Bermuda	6	2.5%	3	0.1%
France	7	2.9%	9	0.3%
Germany	4	1.7%	108	3.3%
Gibraltar	3	1.3%	5	0.2%
Guernsey	33	13.8%	192	5.8%
Iceland	1	0.4%	0	0.0%
Isle of Man	15	6.4%	34	1.0%
Italy	2	0.8%	9	0.3%
Luxembourg	3	1.3%	13	0.4%
Malaysia	1	0.4%	1	0.0%
Malta	3	1.3%	0	0.0%
Republic of Ireland	23	9.6%	552	16.7%
Spain	1	0.4%	4	0.1%
Sweden	2	0.8%	7	0.2%
Switzerland	1	0.4%	1	0.0%
United Kingdom	81	33.9%	2197	66.3%
United States of America	7	2.9%	18	0.5%
Active Underwriters of Lloyd's Syndicates	196 43	82.0% 18.0%	3,231 84	97.5% 2.5%
	239	100.0%	3,315	100.0%

<b><u>Analysis by Number of Votes</u></b>				
0	90	37.7%	0	0.0%
1-25	128	53.6%	427	12.9%
26-50	6	2.5%	197	5.9%
51-100	9	3.8%	703	21.2%
101-150	1	0.4%	106	3.2%
151-200	0	0.0%	0	0.0%
201-250	2	0.8%	411	12.4%
251-300	0	0.0%	0	0.0%
301-350	1	0.4%	344	10.4%
351-400	0	0.0%	0	0.0%
401-450	0	0.0%	0	0.0%
451-500	0	0.0%	0	0.0%
501-550	1	0.4%	526	15.9%
551-600	0	0.0%	0	0.0%
601-650	1	0.4%	601	18.1%
	239	100.0%	3,315	100.0%

## Note

Under Article 32 of the Articles of Association, for the first calendar year of membership a member shall have one vote. Thereafter, under the provisions of Article 30, a member has one vote for each £100,000 of premium or part thereof for reinsurance placed with the Company in the calendar year prior to the poll. Under Article 31, if data for the prior calendar year is not available when the votes are to be cast, data from the previous prior calendar year may be used.