REPORT AND ACCOUNTS

Highway Insurance Company Limited

31 DECEMBER 2008

Registered No. 3730662

Contents

Directory

Directors

	R A Gamble Chairman	(Non – executive)	(Resigned 14 October 2008)
	D F Barker	(Non – executive)	(Resigned 14 October 2008)
	I A Campbell	(Non – executive)	(Resigned 14 October 2008)
	P J Gallagher		(Resigned 23 January 2009)
	A J Gibson		(Resigned 24 October 2008)
	C D Hill		(Resigned 31 January 2009)
	Ms J A Kellie	(Non – executive)	(Resigned 14 October 2008)
	R Kelsey		(Resigned 22 December 2008)
	M S Lawrence		
	A Milton		(Resigned 19 November 2008)
	P L Salsbury	(Non – executive)	(Resigned 14 October 2008)
	K W Abercromby		(Appointed 14 October 2008)
	P M Bunker		(Appointed 14 October 2008)
	S V Castle		(Appointed 14 October 2008)
	S M Daniels		(Appointed 29 October 2008)
	J B O'Roarke		(Appointed 14 October 2008)
	M J Rogers		(Appointed 14 October 2008)
	R A Rowney		(Appointed 14 October 2008)

Secretary

P Cassidy

Auditors

KPMG Audit Plc
8 Salisbury Square
London
EC4Y 8BB

Registered Office

Highway House
171 Kings Road
Brentwood
Essex
CM14 4EJ

Directors' Report

The directors present their report and the audited financial statements for the year ended 31 December 2008.

Principal activity and review of business

Highway Insurance Company Limited (HighCo) is a personal lines insurer underwriting motor insurance in the UK. It underwrites across a number of different business classes including private car comprehensive, private car non-comprehensive, specialist, fleet, motorcycle and commercial vehicle. The Company distributes its insurance products through the broker distribution channel.

In August 2008 an offer was received from Liverpool Victoria Insurance Company Limited to acquire the entire issued share capital of Highway Insurance Group Plc, the Company's listed parent undertaking. This offer became wholly unconditional in October 2008.

Results and dividends

The loss for the year to 31 December 2008 after taxation amounted to £39,198,000 (2007 profit: £13,322,000). A dividend was not paid during the year (2007: £10,000,000).

Directors and their interests

The current directors of the Company are set out on page 2.

The Company is a wholly owned subsidiary of Highway Insurance Group Plc. The ultimate parent company is Liverpool Victoria Friendly Society Limited, an incorporated Friendly Society registered under the Friendly Societies Act 1992.

The directors at 31 December 2008 had no interest in the share capital of the Company at the beginning or the end of the year.

Business review

Business Environment

The principal market in which HighCo operates is the UK motor insurance market.

Highway is one of the few remaining insurers to focus its distribution strategy solely through brokers. This focus has enabled it to forge and develop strong commercial relationships with its key brokers. Highway currently trades with 1,334 intermediaries and now has over 610,000 policyholders.

The UK insurance market continues to be highly competitive both in the motor, home and SME lines of business. Premium rates increased during the year although only marginally ahead of the overall market claims inflation being experienced. Early signs in 2009 suggest that prices (particularly for motor insurance) are starting to move upwards partly in response to the fact that the insurance cycle is on the upturn but also due to the fact that the insurance market is starting to respond to significantly lower anticipated future investment income. However, the continued and increasing impact of the internet in general and aggregators (such as Money Supermarket and Confused.com) as a new but growing distribution channel will continue to ensure that market pricing remains competitive. An increasing proportion of personal lines business is now being conducted through the internet and aggregators.

Business Strategy

Our principal objective is to create value by being a leading provider and distributor of insurance products in our chosen markets. To enable us to deliver this objective the Company will operate best-practice processes and technology in order to provide superior customer service through a people-focused and empowered culture.

Principal risks and uncertainties

UK Insurance Market: The UK motor insurance market moves in a cyclical manner and is currently just emerging from the bottom of its cycle and is highly competitive (where over the last few years claims inflation has exceeded premium inflation thus eroding margins). It is anticipated that 2009 will experience an upturn due in part to the natural upturn in the cycle but also due to the fact that there is now significant pressure on increasing underwriting margins due to the now lower expectations for investment income in the future.

Economic Environment: The current financial and economic environment, in particular in the financial services industry, has meant that expectations from investment income are very uncertain.

Business Change: The Company is going through a significant transformation process (including a new systems implementation) as it positions itself for the future. Such change carries with it an element of risk; however management has mitigated this risk through a disciplined project management approach.

Distribution: The increased influence of the internet and aggregators has changed and continues to change the operating environment. Companies need to be able to respond very quickly to the changing circumstances.

Future outlook

UK market premium rates are expected to increase during 2009, it is projected that the Company will continue to grow its top line in 2009 and 2010. This growth will come in part from anticipated price increase but also from new products and new distribution channels

Key Performance Indicators

In order to monitor our financial performance and measure the achievement of our corporate objectives we use quantitative indicators known as key performance indicators (KPIs). Our principal KPIs are detailed below:

KPI	**Description**	**Comment**	**2008**	**2007**
Gross written premiums	Value of insurance contracts written	There was a fall in gross written premium as continuing competition in the market place effected volumes.	**£236.1m**	£250.6m
Loss ratio	Ratio of claims to net earned premium	The large increase in the loss ratio followed the adoption of Liverpool Victoria's more cautious approach to reserving resulting in a £40m strengthening, as well as a worsening experience in the 2007 and 2008 accident years.	**98.7%**	79.9%
Expense ratio	Ratio expenses to net earned premium	The large increase in the expense ratio has arisen following a change in the accounting estimate for Deferred Acquisition Costs and the recognition of £4m integration costs following the acquisition of the Highway Group by Liverpool Victoria Insurance Company Limited.	**27.5%**	21.8%
Net assets	Value of shareholder's funds	Net assets have decreased by £18.6m as a result of the reported loss incurred in the year, this has been partially offset by a capital contribution of £20m received from Highway Insurance Group Plc.	**£84.5m**	£103.1m

Directors' Report

Financial instruments

The disclosure requirements in respect of financial instruments can be found in note 2 to the financial statements.

Creditor payment policy

The Company agrees terms and conditions under which business transactions with suppliers are conducted. It is the Company's policy that payments to suppliers are made in accordance with these terms, provided that the supplier is also complying with all relevant terms and conditions.

Charitable and political donations

Charitable donations for the year amounted to £450. No donations were made for political purposes.

Provision of information to auditors

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Auditors

As a consequence of the acquisition of the Company by the Liverpool Victoria (LV) group, the directors propose to appoint PricewaterhouseCoopers LLP, LV's auditor, in place of KPMG Audit PLC.

Approved by the Board of directors and signed on its behalf by

P Cassidy
Secretary

31 March 2009

Statement of directors' responsibilities in respect of the directors' report and the financial statements

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 they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice). The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss 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 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; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

Independent Auditors' Report to the members of Highway Insurance Company Limited

We have audited the financial statements of Highway Insurance Company Limited for the year ended 31 December 2008 which comprise Profit and Loss Account, the Balance Sheet, and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 auditor's 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

The directors' responsibilities for preparing the financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in Statement of Directors' Responsibilities on page 6.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2008 and of its loss for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants & Registered Auditor
8 Salisbury Square
London
EC4Y 8BB
31 March 2009

Profit and loss account

For the year ended 31 December 2008

Technical account	Notes	2008 £000	2007 £000
Gross premiums written		**236,116**	250,575
Outward reinsurance premiums		**(38,200)**	(54,277)
Net premiums written		**197,916**	196,298
Change in the gross provision for unearned premiums		**10,733**	(2,405)
Change in the provision for unearned premiums, reinsurers' share		**(8,109)**	1,110
Change in net unearned premiums		**2,624**	(1,295)
Net earned premiums		**200,540**	195,003
Allocated investment return transferred from the non-technical account		**12,626**	16,644
Other technical income		**707**	1,261
Total technical income		**213,873**	212,908
Gross claims paid		**(220,370)**	(202,231)
Reinsurers' share		**42,627**	38,839
Net paid claims		**(177,743)**	(163,392)
Change in claims provision		**(20,779)**	11,802
Reinsurers' share		**2,714**	(5,548)
Change in the provision for claims		**(18,065)**	6,254
Net claims incurred		**(195,808)**	(157,137)
Changes in other technical provisions		**(2,907)**	-
Net operating expenses	6	**(55,217)**	(42,534)
Total technical changes		**(253,932)**	(199,671)
Balance on the technical account – general business		**(40,059)**	13,237

Profit and loss account

For the year ended 31 December 2008

Non-Technical account	Notes	2008 £000	2007 £000
Balance on the general business technical account		**(40,059)**	13,237
Investment return	7	**4,241**	26,948
Investment expenses and charges	7	**(5,700)**	(3,193)
Allocated investment return transferred to the general business technical account	7	**(12,626)**	(16,644)
Other charges		**(677)**	(463)
Operating (loss)/profit		**(54,821)**	19,885
Operating (loss)/profit based on longer term investment return		**(40,736)**	12,774
Short term fluctuation in investment returns	7	**(14,085)**	7,111
(Loss)/profit on ordinary activities before taxation		**(54,821)**	19,885
Taxation on (loss)/profit on ordinary activities	8	**15,623**	(6,563)
(Loss)/profit for the financial year	21	**(39,198)**	13,322

All activities derive from continuing operations. There are no recognised gains or losses or movements in shareholder's funds other than the loss for the financial year. Accordingly, no statement of recognised gains and losses is given.

Balance sheet

As at 31 December 2008

Assets	Notes	2008 £000	2007 £000
Intangible assets	10	**453**	566
Investments			
Financial assets	12	**330,639**	326,195
Reinsurers' share of technical provisions			
Provision for unearned premiums		**17,342**	25,451
Claims outstanding		**106,229**	103,515
		123,571	128,966
Debtors			
Debtors arising out of direct insurance operations – intermediaries		**32,951**	25,150
Debtors arising out of reinsurance operations		**8,303**	897
Other debtors			
Amounts falling due within one year	13	8,533	11,260
Amounts falling due after more than one year	14	9,533	-
		18,066	11,260
		59,320	37,307
Other assets			
Tangible assets	11	**3,753**	4,335
Cash at bank and in hand		**30,673**	46,821
		34,426	51,156
Prepayments and accrued income			
Deferred acquisition costs	16	**15,948**	21,912
Other prepayments and accrued income		**2,063**	4,626
		18,011	26,538
Total assets		**566,420**	570,728

Balance sheet

As at 31 December 2008

Liabilities	Notes	2008 £000	2007 £000
Capital and reserves			
Called up share capital	20	**75,000**	75,000
Capital contribution	21	**20,000**	-
Profit and loss account	21	**(10,528)**	28,106
Equity shareholders funds	21	**84,472**	103,106
Technical provisions			
Provision for unearned premiums		**109,598**	120,331
Claims outstanding		**319,898**	299,119
Other technical provisions		**2,907**	-
		432,403	419,450
Creditors			
Creditors arising out of direct insurance operations		**111**	624
Creditors arising out of reinsurance operations		**1,641**	4,924
Other creditors			
Amounts falling due within one year	17	16,816	17,236
Amounts falling due after more than one year	18	11,429	8,907
		28,245	26,143
		29,997	31,691
Accruals and deferred income		**19,548**	16,481
Total equity and liabilities		**566,420**	570,728

These financial statements were approved by the Board of directors and signed on its behalf on 31 March 2009.

S Castle
Director

Notes to the financial statements

For the year ended 31 December 2008

1 Accounting policies

a) Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards under the historical cost accounting rules.

The financial statements have been prepared in accordance with the Special provisions of Part 1 of Schedule 9A of the Companies Act 1985 relating to insurance companies. The recommendations of the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers in December 2006 have been adopted.

In preparing the financial statements for the current year, the Company has fully implemented FRS 29 Financial Instruments: Disclosures.

b) Cash flow statements

Under Financial Reporting Standard Number 1, Cash Flow Statements, the Company is exempt from the requirement to prepare a cash flow statement on the grounds that a parent undertaking includes the Company in its own published consolidated financial statements.

c) Premiums

Gross written premiums represent premiums (exclusive of IPT) on business incepting during the year, irrespective of whether they relate in whole or in part to a later year, together with adjustments to premiums written in previous years.

The provision for unearned premiums represents that part of gross premiums written which is estimated to be earned after the balance sheet date. Outward reinsurance premiums are accounted for in the same accounting year as the gross premiums to which they relate.

d) Claims

Claims incurred include all losses occurring during the year, whether reported or not, related handling costs and any adjustments to claims outstanding from previous years.

Outstanding claims provisions are based on the estimated ultimate cost of all claims incurred but not settled at the balance sheet date, whether reported or not, together with related claims handling expenses.

e) Technical provisions – claims outstanding

The ultimate cost of outstanding claims including IBNR is estimated by using a range of standard actuarial claims projection techniques, such as the Chain Ladder and Bornhuetter-Ferguson methods. Such methods extrapolate the development of paid and incurred claims, average cost per claim and ultimate claim numbers for each underwriting year, based upon the observed development of earlier years and expected loss ratios.

IBNR provisions and provisions for outstanding claims are initially estimated at a gross level and a separate calculation is carried out to estimate the size of the reinsurance recoveries.

Whilst the directors consider that the gross provisions for claims and the related reinsurance recoveries are fairly stated on the basis of current information available to them, the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amount provided. Adjustments to the amounts of claims provisions established in prior years are reflected in the financial statements for the period in which the adjustments are made, and disclosed separately if material.

The methods used, and the estimates made, are reviewed regularly.

Notes to the financial statements

For the year ended 31 December 2008

1 Accounting policies - continued

f) Unexpired risk provision

A provision for unexpired risks is made when it is anticipated that unearned premiums will be insufficient to meet future claims and claims settlement expenses of business in force at the end of the period after deduction of any acquisition costs deferred.

The provision for unexpired risks is calculated after taking into account the relevant investment return on assets held to back insurance liabilities.

g) Depreciation

Depreciation is calculated to write off the cost of tangible fixed assets on a straight line basis over their estimated useful lives as follows:

Computer software 10 years

The computer and other equipment costs relate to the expenditure incurred in the development and implementation of the GIOS system, this system represents the core operating platform of the business going forward. The company holds a 10 year licence for the system which is expected to have a useful economic life of at least 10 years.

h) Acquisition costs

Acquisition costs, comprise of commission and other costs related to the acquisition of new insurance contracts and the renewal of existing contracts.

They are deferred over the period in which the related premium is earned and to the extent that they are recoverable against future margins.

i) Investment return

Investment income comprises dividends, interest, realised and unrealised gains an losses on assets held at fair value through profit and loss. Fair value realised gains and losses are calculated as the difference between the net sales proceeds and fair value at acquisition. Fair value unrealised gains and losses are calculated as the difference between the current fair value at balance sheet date and fair value at acquisition, adjusted for previously recognised unrealised gains and losses of those financial assets disposed of in the accounting period. Dividend income is recognised when the right to receive payment is established.

The longer term return on investments which support the underwriting activities, initially allocated to the non-technical account, is transferred from that account to the technical account. The actual net investment return from other activities is included within the non-technical account as part of operating profit. The difference between the longer term return allocated to the technical account and the actual return achieved on the underlying assets is recorded in the non-technical account as 'Short term fluctuations in investment return'.

j) Intangible assets

The Company purchased the assets and liabilities of Syndicate 37 by way of a Part VII transfer on 31 July 2007, the excess of the purchase consideration over the fair value of the net assets acquired has been capitalised as an intangible asset.

The intangible asset is being amortised on a straight-line basis over a period of 6 years, which the directors consider to be a reasonable estimate of the future settlement profile of the claims liabilities acquired.

For the year ended 31 December 2008

1 Accounting policies - continued

k) Investments

Financial assets are designated as at fair value through profit and loss on initial recognition.

Financial assets designated as at fair value though profit and loss at inception are those that are managed and their performance is evaluated on a fair value basis, in accordance with a documented Group investment strategy. Information about these financial assets is provided internally on a fair value basis to the Group entity's key management personnel including the Board and Investment Committee. Financial assets carried at fair value through profit or loss are initially recognised at fair value with any associated transaction costs being expensed though the income statement.

The fair value of quoted investments is their quoted bid price at the balance sheet date. If the market for a financial asset is not active, the company establishes fair values by using valuation techniques. These include the use of recent arm's length transactions, references to another transaction that is substantially the same, discounted cash flow analysis and option pricing models. If the value of equity instruments cannot be reliably measured they are measured at cost.

Realised gain and losses, and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in the income statement in the period in which they arise.

The purchase and sales of financial assets are accounted for on a settlement date basis.

l) Tangible assets

The Company has capitalised those costs associated with the development of its software system GIOS. The GIOS system is amortised on a straight-line basis over its estimated useful life, which has been determined as ten years.

m) Foreign currency

Transactions in currencies other than pounds sterling are recorded at the rates of exchange prevailing at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated at the rates prevailing at that date. Foreign exchange differences arising on translation are recognised in the profit and loss account. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated at the rates prevailing when the fair value was determined.

n) Group accounts

The Company is exempt by virtue of Section 228 of the Companies Act 1985 from the requirement to prepare group accounts. These financial statements present information about the Company as an individual undertaking and not about its group.

1 Accounting policies - continued

o) Taxation

Current tax, including UK corporation tax is provided on taxable profits at the rate applicable at the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax.

Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

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

2 Financial risk

The Company undertakes investment activities that expose the Company to financial risk. This section summarises these risks and the way the Company manages them.

Risk management framework
Prior to the acquisition by Liverpool Victoria the Board of Directors had overall responsibility for the establishment and oversight of the Company's risk management framework. The Board reviewed the status and projected outlook of its key/fundamental risks on a quarterly basis.

The Board established a Risk Review Committee for the Company, comprising the senior executives responsible for the key risks in each business area. The purpose of the Risk Review Committee was to define the Company's risk appetite, agree risk policy and strategy, review fundamental (key) risks and oversee the day-today risk management process. The Risk Review Committee had formal terms of reference and all meetings were minuted. Risk Management updates were presented quarterly to the Board.

The Board was responsible for setting the appropriate risk limits and controls for the Company's investment portfolio and established an Investment Committee which was responsible for monitoring adherence to those limits and controls. The Investment Committee met on a quarterly basis to review both the returns and related risks within the investment portfolio. The Committee had both executive and non-executive members from the Company as well as senior representatives from the two investment managers and two independent investment advisors. Investment Committee updates were presented quarterly to the Board.

Post acquisition the Liverpool Victoria Risk management framework will be embedded into the Company during 2009.

Financial risk management
The Company has exposure to the following financial risks from its use of financial instruments, these risks include credit risk, liquidity risk, market risk and operational risk. The Company's exposure to each of the above risks, its policy for measuring and managing these risks and the Company's Management of capital are discussed below.

The focus of financial risk management for the Company is the effective management of its investment portfolio. In late 2003 the Board approved the move to an absolute return strategy with the key objective of optimising returns from the Company's investment portfolio while at the same time ensuring capital preservation.

The Company's investment funds are managed by two international Swiss Banks, Union Bancaire Privee and SYZ Bank, who have extensive experience in operating absolute return strategies. Total funds are split equally between managers. The Investment Managers mandate is to produce steady, positive absolute returns with a low level of volatility, accordingly investment funds have been constructed to invest in a global portfolio of investments diversified amongst several asset classes including fixed income bonds, cash, alternative investments and to a lesser extent equities. The portfolios reflect the Company's conservative approach to risk and the importance based on capital preservation.

The Investment Committee has established guidelines for the Company's Investment Managers within a specific mandate, regarding asset class, exposure limits and quality of asset acceptable to the Company. The mandate is set to ensure compliance at all times to the external investment guidelines set by the FSA. The performance of the Investment Managers is regularly reviewed to confirm adherence to these guidelines.

The Company is currently in the process of restructuring its investment portfolio and investment mandates, it is anticipated that this will be completed in the first half of 2009.

Credit risk
Credit risk is the risk that a counterparty fails to meet its contractual obligations in full as they fall due, resulting in a financial loss to the Company. The key areas of exposure to credit risk for the Company are in relation to its investment portfolio and reinsurance programme and to a lesser extent amounts due from insurance intermediaries and policyholders.

2 Financial risk - continued

The Company structures the levels of credit risk it accepts by placing limits on its exposure to a single counterparty, or groups of counterparty, and to geographical and industry segments.

Investments are primarily allowed only in liquid securities and with counterparties that have a credit rating equal to investment grade or better. Given their high credit ratings, management does not expect any counterparty to fail to meet its obligations. Counterparty exposure is subject to daily review.

Reinsurance exposures are monitored regularly. The Company assesses the credit worthiness of all reinsurers by reviewing public rating information and from internal investigations.

Exposure to insurance intermediaries risk is managed via a stringent credit policy. The Company's credit control function monitors the ageing and collectibility of debtor balances, with credit evaluations performed on all relevant counterparties. The Company does not require collateral in respect of financial assets, however credit risk insurance is purchased to mitigate any potential losses. Intermediary debt at 31 December 2008 was £27.3 million (2007: £20.3 million), all of which was not rated.

The Company's exposure to credit risk by investment grade is summarised below:

As at 31 December 2008	AAA £000	AA £000	A £000	<A £000	Government £000	Not rated £000	Total £000
Financial assets	73,099	61,364	35,343	2,386	92,962	65,485	330,639
Reinsurers' share of technical provisions	-	-	63,047	961	-	59,563	123,571
Debtors (excluding prepayments)							
Neither past due nor impaired	-	-	-	-	-	50,060	50,060
Past due but not impaired	-	-	-	-	-	9,260	9,260
Individually impaired	-	-	-	-	-	2,119	2,119
	-	-	-	-	-	61,439	61,439
Allowance for specific impairment	-	-	-	-	-	(2,119)	(2,119)
	-	-	-	-	-	59,320	59,320
Other assets							
Cash at bank and in hand	-	30,673	-	-	-	-	30,673
Total	73,099	92,037	98,390	3,347	92,962	184,368	544,203

2 Financial risk - continued

As at 31 December 2007	AAA £000	AA £000	A £000	<A £000	Government £000	Not rated £000	Total £000
Financial assets	51,607	81,626	14,148	11,244	76,515	91,055	326,195
Reinsurers' share of technical provisions	-	-	61,195	195	-	67,576	128,966
Debtors (excluding prepayments)							
Neither past due nor impaired	-	-	-	-	-	32,261	32,261
Past due but not impaired	-	-	-	-	-	5,046	5,046
Individually impaired	-	-	-	-	-	450	450
	-	-	-	-	-	37,757	37,757
Allowance for specific impairment	-	-	-	-	-	(450)	(450)
	-	-	-	-	-	37,307	37,307
Other assets							
Cash at bank and in hand	-	46,821	-	-	-	-	46,821
Total	51,607	128,447	75,343	11,439	76,515	195,938	539,289

The Company does not hold any collateral as security or any credit enhancements, such as guarantees, credit derivatives and netting arrangements that do not qualify for offset.

The Company does not monitor concentrations by industry sector or geographical location.

The specific concentration of risk from counterparties where receivables for any one counterparty or group of connected counterparties is £1m or more at the year-end is as follows:

	2008 No of counterparties	**£000**	2007 No of counterparties	£000
Insurance and other receivables	**5**	**12,001**	2	4,865

The Company has insurance and other receivables that are past due but not impaired at the reporting date. The Company believes that impairment of these receivables is not appropriate on the basis of stage of collection of amounts owed. An additional analysis of the carrying amounts of these receivables is presented below.

As at 31 December 2008	**Less than 30 days £000**	**30 – 60 days £000**	**60 – 90 days £000**	**More than 90 days £000**	**Total £000**
Insurance and other receivables					
Agents, brokers and intermediaries	**1,609**	**2,781**	**617**	**3,747**	**8,754**

As at 31 December 2007	Less than 30 days £000	30 – 60 days £000	60 – 90 days £000	More than 90 days £000	Total £000
Insurance and other receivables					
Agents, brokers and intermediaries	3,182	1,280	298	286	5,046

Notes to the financial statements

For the year ended 31 December 2008

2 Financial risk - continued

An analysis of the overall credit risk exposure indicates that the Company has insurance and other receivables that are impaired at the reporting date. The assets that are individually impaired are analysed below:

	2008 £000	2007 £000
Insurance and other receivables		
Agents, brokers and intermediaries	2,119	450

The above assets have been individually impaired after considering information such as the occurrence of significant changes in the counterparty's financial position, patterns of historical payment information and disputes with counterparties.

Liquidity risk
Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with its financial and insurance liabilities. The Company is exposed to daily calls on its available cash resources from claims arising from insurance contracts it has underwritten.

The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities as they fall due, the most significant payments made are claims. The profile of claim payments is highly predictable. The Company maintains cash and liquid deposits to meet demands on daily basis. In normal circumstances, the majority of claims are settled from cash received from intermediaries.

The Company forecasts cash flows on a daily basis to ensure that sufficient liquid funds exist to meet its short term cash outflows, any surplus funds are invested to achieve a higher rate of return.

Market risk
Market risk is the risk that the value of the Company's assets and the amount of its liabilities change as a result of movements in market prices. Market risk comprises three types of risk; foreign exchange, interest rates and market prices.

The principal asset exposed to market risk is the Company's investment portfolio. The Investment Managers selected by the Company understand the key investment objectives, which are: first and foremost to preserve capital and secondly to make a reasonable return from our most significant asset.

Foreign exchange risk
The Company operates within the UK, however it has exposure to foreign currencies through its investment portfolio and financial liabilities. Its main currency exposures are the Euro and the US dollar.

The Company's general policy is to run no foreign exchange risk. However our Investment Managers may from time to time run a small exposure having agreed any such exposure with the Investment Committee.

An open Euro position is maintained to hedge the subordinated note and other minor insurance liabilities.

The Company purchases forward foreign exchange contracts to hedge the exposure to foreign exchange movements.

For the year ended 31 December 2008

2 Financial risk - continued

The Company's exposure to foreign exchange risk is summarised below:

As at 31 December 2008	Sterling £000	USD £000	Euro £000	Other £000	Total £000
Financial assets					
Equities	2,688	6,838	6,405	3,568	19,499
Debt securities – fixed rate	240,807	2,081	15,861	-	258,749
Debt securities – floating rate	1,470	-	944	-	2,414
Collective investment schemes	-	45,539	447	-	45,986
Derivative financial instruments	2,205	974	680	132	3,991
	247,170	55,432	24,337	3,700	330,639
Reinsurers' share of technical provisions	123,571	-	-	-	123,571
Debtors					
Debtors arising out of direct insurance operations – intermediaries	32,951	-	-	-	32,951
Debtors arising out of reinsurance operations	8,303	-	-	-	8,303
Other debtors – amounts falling due within one year	8,532	-	-	-	8,532
Other debtors – amounts falling due after more than one year	9,533	-	-	-	9,533
	59,319	-	-	-	59,319
Other assets					
Cash at bank and in hand	21,899	5,003	2,860	911	30,673
Creditors					
Subordinated note	-	-	(11,429)	-	(11,429)
Derivative financial instruments	(3,080)	(1,201)	(770)	(673)	(5,724)
	(3,080)	(1,201)	(12,199)	(673)	(17,153)
Amount under foreign exchange contracts	67,093	(57,916)	(5,525)	(3,652)	-
Total	515,972	1,318	9,473	286	527,049

For the year ended 31 December 2008

2 Financial risk - continued

As at 31 December 2007	Sterling £000	USD £000	Euro £000	Other £000	Total £000
Financial assets					
Equities	306	10,195	10,748	3,465	24,714
Debt securities – fixed rate	220,998	-	10,444	-	231,442
Debt securities – floating rate	2,483	-	734	-	3,217
Collective investment schemes	388	65,095	856	-	66,339
Derivative financial instruments	179	239	65	-	483
	224,354	75,529	22,847	3,465	326,195
Reinsurers' share of technical provisions	128,966	-	-	-	128,966
Debtors					
Debtors arising out of direct insurance operations – intermediaries	25,150	-	-	-	25,150
Debtors arising out of reinsurance operations	897	-	-	-	897
Other debtors – amounts falling due within one year	11,260	-	-	-	11,260
	37,307	-	-	-	37,307
Other assets					
Cash at bank and in hand	40,520	2,831	3,371	99	46,821
Creditors					
Subordinated note	-	-	(8,889)	-	(8,889)
Derivative financial instruments	(122)	(1,846)	(473)	(155)	(2,596)
	(122)	(1,846)	(9,362)	(155)	(11,485)
Amount under foreign exchange contracts	91,122	(77,507)	(10,546)	(3,070)	-
Total	522,147	(993)	6,310	339	527,804

Interest rate risk

The Company has exposure to interest rate risk primarily from its investment portfolio, and to a lesser extent, its long-term debt obligations.

Interest rate risk within the investment portfolio is managed actively by the Company's Investment Managers, who ensure that investments are selected from a range of asset classes across all major markets with a range of duration. The Investment Committee monitors the Company's exposure to interest rate risk on a quarterly basis.

Price risk

The Company holds a significant portfolio of equities and Collective Investment Schemes (including hedge funds) which are subject to price movements.

The Company holds a portfolio of equities, which are subject to price movements. Our objective is to earn competitive relative returns by investing in a diverse portfolio of high quality liquid securities. Our holdings are diversified across industries and concentrations in any one company or industry are limited by parameters established by the Investment Committee.

2 Financial risk - continued

The Company also invests in a number of Collective Investment Schemes, which are predominately hedge funds. The Investment Managers and Investment Committee apply a stringent process to the selection and subsequent management of these funds. While these funds are not rated their selection for the portfolio is based upon a demonstrable track record of performance. The portfolio is well diversified. Not only are assets spread over a large number of investment managers but also between a number of different strategies. Strategies utilised include macro, long/short equity and relative value. When compared to the overall hedge fund universe the Company's portfolio is considered to be lower return and lower volatility.

Sensitivity analysis to market risks
The table below shows the results of sensitivity testing on the Company's pre-tax profit and equity. The sensitivity analysis indicates the effect of changes in market risk factors arising from the impact of the changes in these factors on the Company's financial assets and liabilities.

	Impact on profit before tax 2008 £000	**Impact on equity 2008 £000**	Impact on profit before tax 2007 £000	Impact on equity 2007 £000
Interest rate risk				
+ 50 basis points shift in yield curve	**(1,246)**	**(891)**	(1,122)	(785)
- 50 basis points shift in yield curve	**1,267**	**906**	1,142	799
Currency risk				
10% increase in euro exchange rate	**2,933**	**2,097**	99	69
10% decrease in euro exchange rate	**(2,912)**	**(2,082)**	(118)	(83)
10% increase in US dollar exchange rate	**(3,498)**	**(2,501)**	-	-
10% decrease in US dollar exchange rate	**3,559**	**2,545**	-	-
Equity price risk				
10% increase in equity markets	**3,506**	**2,486**	4,589	3,212
10% decrease in equity markets	**(4,180)**	**(2,958)**	(4,865)	(3,405)

Assumptions, methodology and limitations of sensitivity analysis
The effects of the specified changes in factors are determined using statistical models, as relevant. The level of movements in market factors on which the sensitivity analysis is based were determined based on economic forecasts and historical experience of variations in these factors.

The above table demonstrates the effect of a change in a key assumption while other key assumptions remain unchanged. However the occurrence of a change in a single market factor may lead to changes in other market factors as a result of inter-correlations and the sensitivity analysis has been modelled to consider this.

The sensitivity analysis does not take into consideration that the Company's assets and liabilities are actively managed. Additionally, the sensitivity analysis is based on the Company's financial position at the reporting date and may vary at the time that any market movement occurs. As investment markets move past pre-determined trigger points, management action would alter the Company's position.

2 Financial risk - continued

Operational risk
Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Operational risks are logged on risk registers. Risk registers are in place for the insurance and broking divisions and for the plc head office. The starting point for the risk registers is the strategy for the particular division. The vision, mission and values underlying the strategy are used to determine the objectives of the division. Risks are then identified within the objective headings that may prevent the division achieving its chosen strategy. Each risk on the Risk Register is ranked according to its severity (based on realistically foreseeable worst case loss) and on its probability of occurrence. A matrix is used to define these ratings, to ensure consistency. The multiplication of the severity and the probability rating generates a raw risk score. The risk ratings take account of existing mitigation. The risk ratings determined by the primary risk owner and are challenged by the other primary risk owners and the Head or Risk Management.

The Risk Registers are maintained by the Head of Risk Management, but responsibility for each risk lies with the risk owner. The Risk Registers are live documents and are updated as and when required. All risks are reviewed at least annually and the development of the fundamental risks are reviewed at least quarterly. Group risk management work focuses on fundamental risks.

Capital management
Capital management policies and objectives:

The Board has overall responsibility for managing the Group's capital base with the principal objective of maintaining sufficient capital to satisfy regulatory requirements. The Board also recognises the need to maintain a strong capital base that provides the necessary protection to policyholders and creditors while at the same time generating sufficient returns to create shareholder value.

The Group's primary capital requirement is to support the underwriting activities undertaken by its FSA regulated insurance company. The level of capital required is determined using the Individual Capital Assessment (ICA) process. This process involves undertaking a comprehensive assessment of the risks faced in the business and then quantifying the amount and composition of capital the Group needs to hold in its insurance company to mitigate these risks to an agreed level of confidence of survival.

As part of the ICA process the Group identifies the major sources of risk and where it is appropriate to hold capital against these risks, to quantify this amount of capital. The amount of capital is calculated using stochastic modelling techniques, where distributions of possible outcomes are specified, giving the relative probability of occurrence of certain events.

The Company fully complied with the externally imposed capital requirements during the reported financial periods and no changes were made to its objectives, policies and process from the previous year. Following the acquisition of the Highway Group by Liverpool Victoria Friendly Society the subsequent alignment of accounting policies and negative investment result for the year generated a significant loss for the period. This required a capital injection of £20m to ensure the Company maintained its solvency.

During the year the Company participated in the QIS 4 study run by the FSA. The Company is currently reviewing the implications of the QIS 4 results and the forthcoming Solvency II proposals on capital requirements. Following the acquisition of the Highway Group by Liverpool Victoria Friendly Society the Company will form part of its Group wide Solvency II project. The Solvency II regime is expected to become fully operational in 2012.

Notes to the financial statements

For the year ended 31 December 2008

3 Segmental analysis

All insurance business written during the period is direct motor insurance written in the United Kingdom. The directors therefore consider that the Company only operates in one segment and consequently no segmental analysis is presented.

4 Remuneration of Directors

The emoluments of the directors were paid by Highway Insurance Group Plc or Highway Group Services PLC and are included in the accounts of this Company as allocated costs within net operating expenses.

5 Staff numbers

The Company has no employees (2007: nil) but utilises the staff of Highway Insurance Group PLC in carrying out its activities, the costs of these staff are recharged on a monthly basis.

6 Net operating expenses – technical account

	2008	2007
	£000	£000
Commission costs	**32,984**	34,639
Movement in deferred acquisition costs	**5,964**	(1,362)
Administrative expenses	**16,269**	9,257
	55,217	42,534

Profit on ordinary activities before taxation	**2008**	2007
	£000	£000
Operating profit is stated after charging the following items:		
Depreciation	**1,163**	1,093
Auditors' remuneration: Fees for the audit of the company	**60**	57

Fees paid to the Company's auditor, KPMG Audit Plc for services other than the statutory audit of the Company are not disclosed in the Highway Insurance Company Limited accounts since the consolidated accounts of Highway Insurance Company Limited's ultimate parent, Liverpool Victoria Friendly Society Limited, are required to disclose non-audit fees on a consolidated basis.

For the year ended 31 December 2008

7 Net investment return

	2008 £000	2007 £000
Investment income	**14,037**	11,949
Realised (losses)/gains on investments	**(10,475)**	9,088
Unrealised gain on investments	**679**	5,911
Investment return	**4,241**	26,948
Investment expenses and charges	**(5,700)**	(3,193)
Net investment return	**(1,459)**	23,755

	2008 £000	2007 £000
Underwriting investment income on a long term rate of return basis transferred to technical account	**12,626**	16,644
Short term fluctuation in investment returns	**(14,085)**	7,111
	(1,459)	23,755

The transfer to the technical account represents the estimated long term rate of return of 4.5% (2007: 5.5%) applied to the investment assets and solvency capital held by the Company's insurance business.

Comparison of the longer term investment return credited to the general business technical account with the actual return included in the non-technical account:

	2004 - 2008 £000	2003 - 2007 £000
Longer term investment return credited to the general business technical account	**72,258**	71,117
Actual return included in the non-technical account	**72,351**	79,970
Shortfall of the longer term investment return over the actual return	**(93)**	(8,853)

A 1% increase in the long term rate of return would result in an increase to the allocated investment return from the non-technical account of £2,806,000 (2007: £3,027,000)

Notes to the financial statements

For the year ended 31 December 2008

8 Taxation on (loss)/profit on ordinary activities

a) UK Corporation tax:	**2008 £000**	2007 £000
UK Corporation tax at 28.5% (2007: 30%):		
Current tax on loss/(profit) for the year	**74**	(6,160)
Adjustments in respect of prior years	**5,998**	(315)
Total current tax credit/(charge)	**6,072**	(6,475)
Deferred tax:		
Current year	**9,551**	(88)
Adjustment in respect of prior years	**-**	-
Total deferred tax credit/(charge)	**9,551**	(88)
Tax on loss/(profit) on ordinary activities	**15,623**	(6,563)

b) Factors affecting tax credit/(charge) for the current period:	**2008 £000**	2007 £000
(Loss)/profit on ordinary activities before tax	**(54,821)**	19,885
Current tax @ 28.5% (2007: 30%)	**15,624**	(5,966)
Effects of:		
Adjustments relating to disallowable expenses	**(525)**	(621)
Accelerated capital allowances	**295**	427
Losses carried back	**(5,935)**	-
Losses carried forward	**(9,511)**	-
Change in tax rate	**126**	-
Adjustments in respect of prior years	**5,998**	(315)
Total current tax charge	**6,072**	(6,475)

The main UK Corporation tax rate reduced from 30% to 28%, effective from 1 April 2008. The weighted average applicable tax rate for the year ended 31 December 2008 is 28.5%.

9 Dividends

	2008 £000	2007 £000
Dividends paid – equity shares	**-**	10,000

10 Intangible assets – acquired insurance relationships

	£000
Cost	
At 1 January 2008 and at 31 December 2008	622
Accumulated amortisation	
At 1 January 2008	56
Charge for the year	113
At 31 December 2008	169
Net book value	
At 31 December 2008	**453**
At 31 December 2007	566

For the year ended 31 December 2008

11 Tangible assets – computer software

	£000
Cost	
At 1 January 2008	9,855
Additions	581
At 31 December 2008	10,436
Accumulated depreciation	
At 1 January 2008	5,520
Charge for the year	1,163
At 31 December 2008	6,683
Net book value	
At 31 December 2008	**3,753**
At 31 December 2007	4,335

12 Investments

	2008 £000	2007 £000
Equities	**19,499**	24,715
Debt securities – fixed rate	**258,749**	231,442
Debt securities – floating rate	**2,414**	3,216
Collective investment schemes	**45,986**	66,339
Derivative financial instruments	**3,991**	483
	330,639	326,195
Listed investments at market value	**177,270**	204,517

At 31 December 2008	**Quoted £000**	**Unquoted £000**	**Gvt Bonds £000**	**Total £000**
Equities	**19,499**	**-**	**-**	**19,499**
Debt securities – fixed rate	**60,972**	**109,806**	**87,971**	**258,749**
Debt securities – floating rate	**2,414**	**-**	**-**	**2,414**
Collective investment schemes	**6,414**	**39,572**	**-**	**45,986**
Derivative financial instruments	**-**	**3,991**	**-**	**3,991**
	89,299	**153,369**	**87,971**	**330,639**

At 31 December 2007	Quoted £000	Unquoted £000	Gvt Bonds £000	Total £000
Equities	24,715	-	-	24,715
Debt securities – fixed rate	85,742	69,185	76,515	231,442
Debt securities – floating rate	3,216	-	-	3,216
Collective investment schemes	14,329	52,010	-	66,339
Derivative financial instruments	-	483	-	483
	128,002	121,678	76,515	326,195

The amount of financial assets that are expected to be recovered more than twelve months after the balance sheet date is £159m (2007: £221m).

13 Debtors – amounts falling due within one year

	2008 £000	2007 £000
Amounts due from fellow group undertakings	**1,304**	10,641
Corporation tax recoverable	**6,759**	-
Other debtors	**470**	619
	8,533	11,260

14 Debtors – amounts falling due after more than one year

	2008 £000	2007 £000
Deferred tax	**9,533**	-

15 Deferred tax asset/(liability)

	2008 £000	2007 £000
Accelerated capital allowances	**22**	(18)
Trading losses available for carry forward	**9,511**	-
	9,533	(18)

The movement in the deferred tax asset/(liability) during the year is as follows:	£000
At 1 January 2008	(18)
Deferred tax credit in the profit and loss account	9,551
At 31 December 2008	**9,533**

The Company has no unprovided deferred tax liabilities.

16 Deferred acquisition costs

Analysis of movement in the deferred acquisition cost asset:

	2008 £000	2007 £000
At 1 January	**21,912**	20,550
Acquisition costs deferred in year	**34,922**	44,356
Amortisation charged to income	**(40,886)**	(42,994)
At 31 December	**15,948**	21,912

Following the acquisition of the Company by Liverpool Victoria Insurance Company Limited (LVIC) on the 24 October 2008 an adjustment was made to the accounting estimates used to determine the deferred acquisition cost asset (DAC) to bring it in line with the methodology used by LVIC. This resulted in a decrease in the DAC asset of £4,669,000 at the date of acquisition.

Notes to the financial statements

For the year ended 31 December 2008

17 Creditors – amounts falling due within one year

	2008 £000	2007 £000
Bank overdrafts	**1,112**	-
Insurance premium tax	**2,598**	2,606
Corporation tax payable	**-**	4,159
Derivative financial instruments	**5,724**	2,596
Amounts due to fellow group undertakings	**-**	160
Uncleared claims payments	**5,086**	4,090
Other creditors	**2,296**	3,625
	16,816	17,236

18 Creditors – amounts falling due after more than one year

	2008 £000	2007 £000
Deferred tax	**-**	18
Subordinated note	**11,429**	8,889
	11,429	8,907

€12,000,000 subordinated note is repayable in 2034. Interest is payable at the 3 month euro deposit rate plus a margin of 3.65%.

19 Claims outstanding

Included within the claims incurred in the technical account is an amount of £1,945,000 - debit (2007: £5,733,000 - debit) being the difference between the provision for claims outstanding at the beginning of the year less payments made during the year on account of claims incurred in previous years and the provision for claims outstanding at the end of the year for such claims.

20 Share capital

	2008	2007
Number of shares:		
Ordinary shares (000's)	**75,000**	75,000
	2008 £000	2007 £000
Authorised, allotted, issued and fully paid:		
Ordinary shares of £1 each	**75,000**	75,000

Notes to the financial statements

For the year ended 31 December 2008

21 Reconciliation of movements in shareholder's funds

	Share capital £000	Capital contribution £000	Profit and loss account £000	Total £000
At 1 January 2008	75,000	-	28,106	103,106
Loss for the financial year	-	-	(39,198)	(39,198)
Share based payments	-	-	564	564
Capital contribution	-	20,000	-	20,000
At 31 December 2008	**75,000**	**20,000**	**(10,528)**	**84,472**

On 22 December 2008 the Company received a non-returnable capital contribution of £20m from Highway Insurance Group Plc. This amount is distributable in future periods, subject to the provisions of the Companies Act.

22 Post balance sheet event

On 24 February 2009 the Company received a £10m capital contribution from Highway Insurance Group Plc.

23 Related party transactions

The Company has taken advantage of the exemption in Financial Reporting Standard 8(3) from disclosure of related party transactions with other entities included in the consolidated financial statements of Liverpool Victoria Friendly Society Limited.

24 Ultimate parent society

The ultimate parent company is Liverpool Victoria Friendly Society Limited, an incorporated Friendly Society registered under the Friendly Societies Act 1992. The immediate parent company is Highway Insurance Group Plc.

The consolidated accounts of Liverpool Victoria Friendly Society Limited are available to the public and may be obtained from the Company Secretary, County Gates, Bournemouth, BH1 2NF.