

COMPANY REGISTRATION NO

3730662

**HIGHWAY  
INSURANCE COMPANY LIMITED**

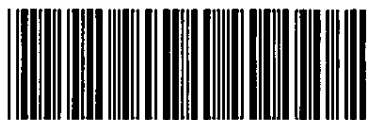
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**REPORT AND  
ACCOUNTS**

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**FOR THE YEAR ENDED 31 DECEMBER 2009**

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**HIGHWAY INSURANCE COMPANY LIMITED**

**REPORT AND ACCOUNTS 31 DECEMBER 2009**

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## **HIGHWAY INSURANCE COMPANY LIMITED**

### **DIRECTORS, OFFICERS AND REGISTERED OFFICE**

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#### **Directors**

K W Abercromby

P M Bunker

S V Castle

S M Daniels

P J Gallagher

(Resigned 23 January 2009)

C D Hill

(Resigned 31 January 2009)

P A Horton

(Appointed 5 May 2009)

M S Lawrence

(Resigned 29 May 2009)

J B O'Roarke

M J Rogers

R A Rowney

#### **Secretary**

P B Cassidy

#### **Registered office**

County Gates

Bournemouth

BH1 2NF

Tel 01202 292333

Fax 01202 751825

#### **Auditor**

PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

31 Great George Street

Bristol

BS1 5QD

**DIRECTORS' REPORT**

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The Directors submit their annual report and the audited accounts of Highway Insurance Company Limited (the 'Company', 'HICO') for the year to 31 December 2009

**1. Results and dividends**

The loss on ordinary activities for the year after taxation was £36,367,000 (2008 £38,503,000) as set out on page 8 The Directors proposed and paid no dividends in the current year (2008 £nil)

**2. Principal activities**

The principal activity of the Company is to carry on general insurance business through the broker distribution channel The primary sources of premium income are from the sale of motor insurance products Motor insurance products include private car, specialist, fleet, motorcycle and commercial vehicles

The Company was acquired by Liverpool Victoria Insurance Company in October 2008 During 2009 a significant amount of administration integration activities has been carried out The integration project was largely complete by the 2009 year end

**3. Review and developments**

**(a) Results & performance**

The 2009 results for the Company show a loss after tax of £36,367,000 This is comparable to the result in 2008 During 2009 the company undertook a full restructuring and integration exercise and has, at the same time, re-underwritten and re-priced the existing insurance portfolio The benefits of these actions will be seen in future years

The following factors have had a material effect on the result for the year (see also the Key Performance Indicators (KPI) below)

- 1 Premium income growth The Company has seen significant premium income growth in 2009 Growth has been seen across all products This growth has come from both business volume increases and price increases The new business acquired was written at rates which will mean that increased margins will be earned through into 2010
- 2 Investment income Overall investment returns in 2009 have been depressed primarily due to the difficult financial markets in 2009 However after a poor first half of the year investment income did recover to a certain extent during the second half of the year to mitigate the overall returns
3. Expenditure As part of the integration activities associated with the Company being acquired by Liverpool Victoria Insurance Company there has been a significant investment in staff, systems and infrastructure This activity was aimed at ensuring that the organisation was fully integrated into the LV= Group and that it is well placed to deliver a profitable growth strategy in future
- 4 Underwriting and Claims During 2009 the Company has worked on developing its products and improving pricing and underwriting activities In addition significant work has been done in the claims area aimed at improving the efficiency of claims processes and reducing claims leakage As a result in 2009 the Company has continued to record improving trends in relation to its underlying ongoing claims experience There has however been some strengthening of the claims reserves in part to align with the more conservative reserving policies of the wider Liverpool Victoria General Insurance Group

Management views 2009 as a turnaround year for the Company The Company has now been fully integrated into the LV= Group The reserves and statement of financial position have been strengthened and the book of business re-underwritten

## DIRECTORS' REPORT

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### (b) Business environment

At the beginning of 2009 the UK motor insurance markets were expected to move upwards (i.e. implement price increases) partly in response to the fact that the insurance cycle was on the upturn anyway (due to reducing underwriting margins) but also due to the fact that the insurance market would need to respond significantly to the lower investment income returns being experienced. These expectations have overall been either met or exceeded in 2009 with the market supporting good price increases across most products throughout the year. Most companies are currently prioritising margin growth over market share. Early signs in 2010 are that this may continue for a period though the rate of price increases may slow. However, as 2010 develops it is expected that more competition will be seen returning to the market. The competition will build as underwriting results improve and as the investment returns start to move back to long term levels. In addition the continued and increasing impact of the internet in general and aggregators (such as Money Supermarket and Confused.com) in particular will ensure that competitive market pricing returns sooner rather than later.

### (c) Strategy

Highway Insurance Company is part of the Liverpool Victoria General Insurance Group (LVGIG). The long term objective of LVGIG as a whole is as follows:

"To become a top five general insurer in its target markets and to be active in all major channels: direct, broker, affinity and white-label. It will be focused on three core products, namely Motor, Home and Commercial supported by minor offerings such as Road Rescue, Travel and Pet, and will utilise a range of strong brands including LV=, Highway, ABC and Britannia Rescue. The Company will operate best-practice processes and technology in order to provide superior customer service through a people-focused and empowered culture. LVGIG will ultimately deliver attractive and consistent returns to the members of the ultimate parent company."

Highway will concentrate upon the broker distribution channel within LVGIG.

### (d) Principal risks and uncertainties

**UK Insurance Market** The UK motor insurance market moves in a cyclical manner and is currently supporting price increases as most companies are aiming for underwriting margin rather than market share – the main driver of this being the depressed investment income levels. It is anticipated that whilst 2010 will see further price increases in the early part of 2010 at some point the market will see increasing price competition as the insurance companies return to acceptable underwriting and investment returns. The timing and extent of this increasing price competition are not easy to predict.

**Economic Environment** The current financial and economic environment, in particular that in the financial services industry, has meant that expectations from investment income over the next few years are very uncertain. The Company will also need to pay particular attention to credit risk and increased claims leakage through fraud.

**Business Change** The Company is going through a significant transformation process (including a full review of its systems strategy) 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 increasing 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.

### (e) Future outlook

It is projected that the Company will return to profitability in 2010. In addition it will continue to grow its top line in 2010 and 2011. This growth will come in part from anticipated price increases but also from increased volumes from broker operations. However it should be noted that the volume growth will be moderated to ensure that margins are preserved.

## HIGHWAY INSURANCE COMPANY LIMITED (COMPANY REGISTRATION NO 3730662)

### DIRECTORS' REPORT

#### (f) Significant post balance sheet events

There have been no events of significance affecting the Company since the balance sheet date

#### (g) Key performance indicators

The Board sets key performance indicators (KPI) and targets for its main operating entities, which it monitors on a regular basis throughout the year. These KPI change from time to time as objectives and priorities change. During 2009, the KPI were focused on premium income growth, the successful integration of the Company into the LV= Group and the re-underwriting of the poorly performing portfolio.

The Company uses many detailed KPI to monitor performance. The main high level ones are as follows:

KPI	2009	2008	Comments
<b>Premiums receivable</b>	£286.8m	£236.1m	Premiums receivable is higher due to the following factors: 1 Good price increases across the product range 2 Good volume growth being achieved even with the increased prices 3 Good support from the broker market in response to the new ownership and a new strategic approach
<b>Loss ratio</b>	101.3%	99.1%	The overall net Loss Ratio for 2009 is high due to adverse claims experience on the existing book of business and through a revision of the Company's overall claims reserving policy. During 2009 the insurance portfolio was fully re-underwritten and re-priced. In addition both renewals and new business benefited from the significant price rises that were seen in the market in 2009. The loss ratio is therefore expected to reduce down to acceptable levels in 2010.
<b>Expense ratio</b>	25.1%	28.7%	The Expense Ratio at 25.1% has decreased from 2008. The company is now benefiting from the investments made in 2009 and these will be seen in the expense ratio to a greater effect in 2010.
<b>Combined ratio</b>	126.4%	127.8%	The Combined Ratio of 126.4% is comparable to 2008. The reasons for this being so high have been outlined above. Significant improvements in the Combined Ratio are anticipated both from improvements in the Loss Ratio and the Expense Ratio in 2010 and over the next few years.
<b>Investment return</b>	£10.4m	£2.4m	Investment return includes 1 Investment income and 2 Net fair value gains/losses on financial assets. Whilst investment returns in 2009 at £10.2m were well up on 2008 it was still a poor year. The depressed financial markets did recover to a certain extent in the second half of the year but not enough to recover all the lost ground.
<b>Net assets</b>	£133.9m	£80.3m	Net assets have been impacted during the year by: 1 The loss for the year of £36.4m 2 The capital injections received from the parent company (Highway Insurance Group Plc) of £90.0m

#### 4. Directors and their interests

The present members of the Board and the members who served during the year are listed on page 1.

**DIRECTORS' REPORT**

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**5. Parent company**

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

**6. Employees**

The Company did not directly employ any staff during 2009. Instead it utilised the staff and premises of Liverpool Victoria Friendly Society Limited and Highway Group Services Plc in carrying out its activities and incurred the cost of staff through intercompany management charges.

**7. Charitable and political donations**

During 2009 the Company made £702 (2008 £450) of charitable donations. No political donations have been made during 2009 (2008 £nil).

**8. Statement of disclosure of information to auditor**

Each Director at the date of this report confirms that

- so far as he is aware, there is no relevant audit information of which the Company's auditor is unaware, and
- he has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

**9. Auditor**

During the year KPMG Audit Plc resigned as auditor and PricewaterhouseCoopers LLP was appointed in succession.

**10. 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 International Financial Reporting Standards (IFRS) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether applicable International Financial Reporting Standards (IFRS) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements,
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

**APPROVED BY THE BOARD OF DIRECTORS AND SIGNED BY ORDER OF THE BOARD**



P B Cassidy  
Secretary  
25 March 2010

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF HIGHWAY INSURANCE COMPANY LIMITED**

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We have audited the financial statements of Highway Insurance Company Limited for the year ended 31 December 2009 which comprise the Statement of Comprehensive Income, the Statement of Changes in Equity, the Statement of Financial Position, the Statement of Cashflows and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

As explained more fully in the Directors' Responsibilities Statement on page 5, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit 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.

### **Opinion on financial statements**

In our opinion the financial statements

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

### **Opinion on other 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.



**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF  
HIGHWAY INSURANCE COMPANY LIMITED**

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**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

David Roper (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
31 Great George Street  
Bristol  
BS1 5QD

*15 MARCH 2010*

# HIGHWAY INSURANCE COMPANY LIMITED

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

	Note	2009 £000	2008 £000
Insurance contract premium revenue	6	257,118	246,849
Insurance contract premium ceded to reinsurers	6	(21,552)	(46,309)
<b>Net premium revenue</b>		<b>235,566</b>	<b>200,540</b>
Investment income	7	9,936	14,037
Net fair value gains/(losses) on financial assets at fair value through income	8	450	(11,660)
Other income		423	707
<b>Total income</b>		<b>246,375</b>	<b>203,624</b>
Insurance claims and loss adjustment expenses	9	(265,431)	(244,056)
Insurance claims and loss adjustment expenses recoverable from reinsurers	9	26,754	45,341
<b>Net insurance claims</b>		<b>(238,677)</b>	<b>(198,715)</b>
Finance costs	10	(580)	(837)
Other operating and administrative expenses	11	(59,475)	(58,198)
<b>Total claims and expenses</b>		<b>(298,732)</b>	<b>(257,750)</b>
<b>Loss before tax</b>		<b>(52,357)</b>	<b>(54,126)</b>
Income tax credit	14	15,990	15,623
<b>Loss for the year</b>		<b>(36,367)</b>	<b>(38,503)</b>
Share based payments		-	564
<b>Total comprehensive income for the year</b>		<b>(36,367)</b>	<b>(37,939)</b>

All balances relate to continuing business

The notes on pages 12 to 43 are an integral part of the accounts

# **HIGHWAY INSURANCE COMPANY LIMITED**

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

	<b>Attributable to equity holder of the Company</b>			
	<b>Called up share capital</b>	<b>Retained deficit</b>	<b>Capital reserve</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
Balance at 1 January 2009	75,000	(14,734)	20,000	80,266
Capital contributions	-	-	90,000	90,000
Loss for the year	-	(36,367)	-	(36,367)
<b>Balance at 31 December 2009</b>	<b>75,000</b>	<b>(51,101)</b>	<b>110,000</b>	<b>133,899</b>

	<b>Attributable to equity holder of the Company</b>			
	<b>Called up share capital</b>	<b>Retained deficit</b>	<b>Capital reserve</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
Balance at 1 January 2008	75,000	23,205	-	98,205
Capital contributions	-	-	20,000	20,000
Loss for the year	-	(38,503)	-	(38,503)
Shared based payments	-	564	-	564
<b>Balance at 31 December 2008</b>	<b>75,000</b>	<b>(14,734)</b>	<b>20,000</b>	<b>80,266</b>

The notes on pages 12 to 43 are an integral part of the accounts

# HIGHWAY INSURANCE COMPANY LIMITED

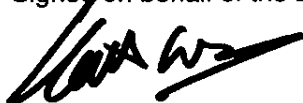
## STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2009

	Note	2009 £000	2008 £000
<b>Assets</b>			
Deferred acquisition costs	15	17,194	15,948
Financial assets			
- Fair value through income	16	384,227	216,842
- Derivative financial instruments	17	-	3,991
Insurance receivables	18	37,297	41,254
Trade and other receivables	19	14,389	3,788
Reinsurance assets	20	105,614	123,571
Deferred tax asset	21	15,098	9,533
Current tax asset	22	6,048	6,759
Cash and cash equivalents	23	89,114	139,367
<b>Total assets</b>		<b>668,981</b>	<b>561,053</b>
<b>Liabilities</b>			
Insurance contracts	24	512,090	437,826
Financial liabilities			
- Derivative financial instruments	17	106	5,724
- Other financial liabilities	25	10,662	11,380
Insurance payables	26	3,703	1,752
Trade and other payables	27	8,521	24,105
<b>Total liabilities</b>		<b>535,082</b>	<b>480,787</b>
<b>Equity</b>			
Called up share capital	28	75,000	75,000
Capital reserve	29	110,000	20,000
Retained deficit	30	(51,101)	(14,734)
<b>Total equity</b>		<b>133,899</b>	<b>80,266</b>
<b>Total liabilities and equity</b>		<b>668,981</b>	<b>561,053</b>

The notes on pages 12 to 43 are an integral part of the accounts

These accounts were approved by the Board of Directors on 25 March 2010

Signed on behalf of the Board of Directors



K W Abercromby

**HIGHWAY INSURANCE COMPANY LIMITED**

**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2009**

	<b>Note</b>	<b>2009 £000</b>	<b>2008 £000</b>
<b>Cash and cash equivalents at 1 January</b>	<b>23</b>	<b>139,367</b>	<b>116,006</b>
<b>Cash flows arising from:</b>			
<b>Operating activities</b>			
Cash (used in)/generated from operating activities	31	(140,423)	9,044
Finance cost paid		(580)	(837)
Group relief		(3,795)	-
Income tax refund received/(tax paid)	22	4,545	(4,846)
<b>Net cash flows (used in)/ from operating activities</b>		<b>(140,253)</b>	<b>3,361</b>
<b>Financing activities</b>			
Proceeds from capital contribution	29	90,000	20,000
<b>Net cash flows from financing activities</b>		<b>90,000</b>	<b>20,000</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(50,253)</b>	<b>23,361</b>
<b>Cash and cash equivalents at 31 December</b>	<b>23</b>	<b>89,114</b>	<b>139,367</b>

The notes on pages 12 to 43 are an integral part of the accounts

# **HIGHWAY INSURANCE COMPANY LIMITED**

## **NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009**

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### **1. General information**

Highway Insurance Company Limited is a company limited by shares, domiciled and incorporated in the United Kingdom. The Company underwrites general insurance risks, including motor and household risks. All contracts of insurance are written in the United Kingdom and Republic of Ireland.

### **2. Basis of presentation**

#### **Basis of presentation**

These accounts of Highway Insurance Company Limited have been prepared in accordance with International Financial Reporting Standards (IFRS), as endorsed by the European Union ('EU') and the International Financial Reporting Interpretations Committee ('IFRIC') and also with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

IFRS 1, First-time Adoption of International Financial Reporting Standards, with the provisions of statutory instrument 2008/410, Schedule 3 and Schedule 6 part 3 to the Companies Act 1985 and the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers in December 2005, as amended in December 2006 ("ABI SORP"), has been applied in preparing these accounts. These accounts are the first accounts to be prepared in accordance with IFRS.

Reconciliations and descriptions of the effects of the transition from UK Generally Accepted Accounting Principles (GAAP) to IFRS on the Company's statement of comprehensive income and statement of financial position are given in note 34.

These accounts have been prepared under the historic cost convention, as modified by the revaluation of financial assets and liabilities at fair value through income, and are presented in thousand of pounds (£000).

The preparation of the accounts in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the accounts are disclosed in note 4.

### **3. Accounting policies**

#### **Investment income**

Investment income includes dividends, interest on deposits, interest on loan advances to customers and rents. Dividends are included on an ex-dividend basis. Interest on deposits, rents and expenses are included on an accruals basis. Interest income for financial assets that are not classified as "fair value through income" is recognised using the effective interest method. The effective interest rate is calculated at outset by discounting the asset's estimated cash flows back to its net carrying amount.

#### **Premiums**

General insurance premiums written reflect business coming into force during the year. Earned premium is written premium adjusted for unearned premium. Unearned premium is that proportion of a premium written in a year that relates to periods of risk after the balance sheet date. Unearned premiums are calculated on a time apportionment basis. The proportion attributable to subsequent periods is deferred as a provision for unearned premiums.

#### **Foreign currencies**

Monetary assets and liabilities denominated in foreign currencies are translated to sterling at rates of exchange ruling at the end of the year. Purchases and sales of investments denominated in foreign currencies are translated at the rates prevailing at the dates of the respective transactions. Exchange gains and losses are recognised within the statement of comprehensive income.

## **HIGHWAY INSURANCE COMPANY LIMITED**

### **NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009**

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#### **Fair value gains and losses on financial assets**

Realised gains and losses on financial assets are calculated as the difference between net sales proceeds and original cost

Unrealised gains and losses on financial assets represent the difference between the valuation of fair value investments at the statement of financial position date and their purchase price or, if they have been previously revalued, their valuation at the last statement of financial position date. An adjustment is made to unrealised gains and losses for the prior year's unrealised element included in the current year's realised gains and losses

#### **Income taxes**

The income tax expense reflects the movement in current and deferred income tax in respect of income, gains, losses and expenses

##### **- Current income tax**

Current income tax liabilities and assets are measured at the amount expected to be paid to or recovered from the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the statement of financial position date

##### **- Deferred tax**

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the Company controls the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

#### **Deferred acquisition costs**

The costs of acquiring new business, which are incurred during the financial year, but where the benefit of such costs will be obtained in subsequent accounting periods, are deferred and recognised as an asset to the extent that they are recoverable out of margins in future matching revenues. In respect of insurance contracts, acquisition costs comprise of all direct and indirect costs incurred in writing new contracts.

Deferred acquisition costs are written off in line with the recognition of premiums. Commissions and other acquisition costs that relate to serving new contracts and renewing existing contracts are capitalised as an intangible asset. All other costs are expensed when they are incurred. The asset is subsequently amortised over the life of the policy as the premium is earned.

#### **Financial assets at fair value through income**

Financial assets at fair value through income has two sub categories

- financial assets held for trading, and
- those designated at fair value through income at inception

All investments of the Company classified as fair value are designated as fair value through income at inception. This is in accordance with the Company's documented investment strategy and consistent with investment risk being assessed on a portfolio basis. Such assets are valued at market prices, or prices consistent with market ratings should no price be available. Any unrealised or realised gains or losses are taken to the statement of comprehensive income, as fair value gains or losses, or realised gains or losses respectively, as they occur.

## **HIGHWAY INSURANCE COMPANY LIMITED**

### **NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009**

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#### **Collective Investment Schemes**

Collective Investment Schemes are included within financial assets at fair value through income and their accounting treatment is consistent with that of financial assets at fair value through income

#### **Impairment of assets**

##### **(a) Financial assets carried at amortised cost**

The Company assesses at each statement of financial position whether there is objective evidence that a financial asset or group of financial assets is impaired. Impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of financial assets is impaired includes observable data that comes to the attention of the Company about the following events

- (i) significant financial difficulty of the issuer or debtor,
- (ii) a breach of contract, such as a default or delinquency in payments,
- (iii) it becoming probable that the issuer or debtor will enter bankruptcy or other financial reorganisation,

The Company first assesses whether objective evidence of impairment exists for individually significant financial assets and if no such individual impairment exists it collectively considers impairments of groups of assets with similar credit risks

Where there is objective evidence that the carrying value is impaired, the loss is recognised in the statement of comprehensive income for the period

##### **(b) Non-Financial assets**

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows



## **HIGHWAY INSURANCE COMPANY LIMITED**

### **NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009**

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#### **Liability adequacy test**

At each balance sheet date liability adequacy tests are performed to ensure the adequacy of insurance contract liabilities, net of related DAC. In performing these tests current best estimates of future contractual cash flows and claims handling and administration expenses as well as investment income from the assets backing such liabilities are used. Any deficiency is immediately charged to the statement of comprehensive income initially by writing off DAC and by subsequently establishing a provision for losses arising from liability adequacy tests. Any DAC written off as a result of this test cannot subsequently be reinstated.

#### **Derivative financial instruments**

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value.

Changes in the fair value of derivative instruments are recognised immediately in gains or losses on investments in the statement of comprehensive income for the period. Realised gains or losses are similarly taken to the statement of comprehensive income on occurrence.

#### **Insurance receivables and payables**

Insurance receivables and payables are recognised when due and include amounts due from or to agents, brokers and insurance contract holders. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income.

#### **Trade and other receivables**

Trade and other receivables are recognised when due and comprise amounts due to the Company from group undertakings and other receivables. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income.

#### **Claims and insurance contract liabilities**

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

Provision is made for the estimated cost of claims incurred but not settled, including the cost of claims incurred but not reported. The estimated cost of claims includes expenses to be incurred in settling claims and a deduction for the expected value of recoveries. However, given the inevitable uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established. Provisions are adjusted at the statement of financial position date to represent a best estimate of the expected outcome.

Standard actuarial claims projection techniques are used to estimate outstanding claims. Such methods extrapolate the development of paid and incurred claims, recoveries from third parties, average cost per claim and ultimate claim numbers for each accident year, based upon the observed development of earlier years and expected loss ratios. The main assumption underlying these techniques is that past claims development experience can be used to project ultimate claims costs. Allowance for one off occurrences or changes in legislation, policy conditions or portfolio mix, is also made in arriving at the estimated ultimate cost of claims, in order that it represents the most likely outcome, taking account of all the uncertainties involved. To the extent that the ultimate cost is different from the estimate, where experience is better or worse than that assumed, the surplus or deficit will be credited or charged to the statement of comprehensive income in future years.

Provisions are calculated allowing for reinsurance recoveries and a separate asset is recorded for the reinsurers' share of the provision.

## **HIGHWAY INSURANCE COMPANY LIMITED**

### **NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009**

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#### **Reinsurance contracts**

The Company cedes reinsurance risk in its general insurance business. Reinsurance assets represent balances due from reinsurance companies. Recoverable amounts are estimated in a manner consistent with the outstanding claims provision and in accordance with the reinsurance contracts.

An impairment review is performed at the statement of financial position date. Impairment occurs when there is evidence that the Company will not recover outstanding amounts under the contract, such losses being recorded immediately in the statement of comprehensive income.

#### **Amounts recoverable from or due to reinsurers**

Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

#### **Trade and other payables**

Trade and other payables are recognised when due and include amounts due to group undertakings and accruals.

#### **Share capital**

Shares are classified as equity when there is no obligation to transfer cash or other assets.

#### **Cash and cash equivalents**

Cash and cash equivalents comprise cash at bank and in hand, and short term deposits with an original maturity of three months or less.

For the purpose of the cash flow statement, cash and cash equivalents are as defined above but are shown net of outstanding bank overdrafts.

## **HIGHWAY INSURANCE COMPANY LIMITED**

### **NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009**

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#### **CHANGES IN ACCOUNTING POLICIES**

##### **(i) Standards, amendments to published standards and interpretations effective on or after 1 January 2009**

The following amendments to published standards are mandatory for the Company's accounting periods beginning on or after 1 January 2009

IAS 1 (Revised), 'Presentation of financial statements' (effective from 1 January 2009) The revised standard prohibits the presentation of items of income and expenses (that is, 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity in a statement of comprehensive income. As a result, the Company presents in the statement of changes in equity all owner changes in equity, whereas all non-owner changes in equity are presented in the statement of comprehensive income. Comparative information has been presented so that it also conforms to the revised standard.

IFRS 7, 'Financial instruments – Disclosures' (Amendment), requires enhanced disclosures about fair value measurement and liquidity risk. The Company has adopted the amendment to IFRS 7 with effect from 1 January 2009. This requires disclosure of fair value measurement by level of the following fair value measurement hierarchy:

- Quoted prices (unadjusted) in active market for identical assets or liabilities (Level 1),
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as process) or indirectly (that is, derived from prices) (Level 2),
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3)

IAS 39 and IFRS 7, 'Reclassification of financial assets' (Amendment), permits an entity to reclassify non-derivative financial assets (other than those designated at fair value through income by the entity upon initial recognition) out of the fair value through income category in particular circumstances. The amendment also permits an entity to transfer from available for sale category to the loans and receivables (if the financial asset has not been designated as available for sale), if the entity has the intention or ability to hold that financial asset for the foreseeable future.

##### **(ii) Standards, amendments to published standards and interpretations early adopted by the Company**

In 2009, the Company did not early adopt any new, revised or amended standards.

##### **(iii) Standards and interpretations effective in 2009 but not relevant to the Company's operations**

IAS 16 'Property, plant and equipment' (and consequential amendment to IAS 7)  
IAS 20 'Accounting for government grants and disclosure of government assistance' (Amendment)  
IAS 29 'Financial reporting in hyperinflationary economies'  
IAS 31 'Interests in joint ventures' (and consequential amendment to IAS 32 and IFRS 7)  
IAS 32 and IAS 1 'Puttable financial instruments and obligations arising on liquidation'  
IAS 38 'Intangible assets'  
IAS 41 'Agriculture'  
IFRIC 13 'Customer loyalty programmes'  
IFRIC 15 'Agreements for the construction of real estates'

## **HIGHWAY INSURANCE COMPANY LIMITED**

### **NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009**

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#### **(iv) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Company**

The following standards and amendments to existing standards have been published and are mandatory for the Company's accounting periods beginning on or after 1 January 2010 or later periods, but the Company has not early adopted them

**IAS 1 (Amendment), 'Presentation of financial statements'** The amendment is part of the IASB's annual improvements project published in April 2009. The amendment provides clarification that the potential settlement of a liability by the issue of equity is not relevant to its classification as current or non-current. By amending the definition of current liability, the amendment permits a liability to be classified as non-current (provided that the entity has an unconditional right to defer settlement by transfer of cash or assets for at least 12 months after the accounting period) notwithstanding the fact that the entity could be required by the counterparty to settle in shares at any time. The Company will apply IAS 1 (amendment) from 1 January 2010. It is not expected to have a material impact on the Company's financial statements.

**IAS 24 (Amendment), 'Related party disclosures'** The amendment relaxes the disclosures of transactions between government-related entities and clarifies related-party definition. The amendment is not expected to have an impact on the Company's financial statements.

**IAS 39 (Amendment), 'Financial instruments: recognition and measurement – Eligible hedged items'** The amendment was issued in July 2008. It provides guidance in two situations: on the designating of one-sided risk in a hedged item, IAS 39 concludes that a purchased option designated in its entirety as the hedging instrument as a one-sided risk will not be perfectly effective. The designation of inflation as a hedged risk or portion is not permitted unless in particular situation. It is not expected to have a material impact on the Company's financial statements.

## **HIGHWAY INSURANCE COMPANY LIMITED**

### **NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009**

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#### **4. Significant accounting judgements, estimates and assumptions**

In applying the Company's accounting policies, Management has made the following judgements, estimations and assumptions which have the most significant effect on the accounts

##### **Fair value of financial assets**

In view of recent market dislocation, the markets for some assets have become less liquid and therefore the valuations are less certain than in previous years. In the absence of an active market, estimation of fair value is achieved by using valuation techniques such as recent arm's length transactions, discounted cash flow analysis, the application of suitable indices to earlier valuations and option pricing models. This valuation will also take into account the marketability of the assets being valued.

##### **Valuation of general insurance contract liabilities**

For general insurance contracts, estimates are made for the expected ultimate cost of claims as at the statement of financial position date and the cost of claims incurred but not yet reported to the Company. It can take a significant period of time before the ultimate cost of claims can be established with certainty, and the final outcome may be better or worse than that provided. The estimation of these claims is based on historical experience projected forward.

##### **Outstanding claims**

The estimation of the ultimate liability arising from claims made under insurance contracts is the Company's most critical accounting estimate. There are several sources of uncertainty that need to be considered in the estimate of the liability that the Company will ultimately pay for such claims.

In particular, motor insurance policies are exposed to claims for bodily injury claims.

Estimation of the ultimate bodily injury claims is a complex process and cannot be done using conventional actuarial techniques. Significant factors that affect the trends that influence the bodily injuries estimation process are the inconsistent court resolutions and jurisprudence that has broadened the intent and scope coverage of the protection offered in the insurance contracts issued by the Company. This factor is exacerbated by the geographical diversification of the Company bodily injury claims. The current case law in all the territories in which the Company is exposed to these claims can be characterised as still evolving, it is unlikely that any firm direction will emerge in the courts' compensation methods in the near future. Due to this uncertainty, it is not possible to determine the future development of bodily injury claims with the same degree of reliability as with other types of claims.

While management believes that the liability carried at year end is adequate, the application of statistical techniques requires significant judgment.

## HIGHWAY INSURANCE COMPANY LIMITED

### NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

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#### 5. Capital management and risk management and control

The Company maintains an efficient capital structure from a combination of equity shareholders' funds and borrowings, consistent with the Company's risk profile and the regulatory and market requirements of its business

The Company retains capital to meet four key objectives

- (i) To ensure financial stability,
- (ii) To enable the Company's strategy to be developed,
- (iii) To give confidence to consumers and other stakeholders who have relationships with the Company, and
- (iv) To comply with capital requirements imposed by its UK regulator, FSA

At least annually, these objectives are reviewed and benchmarks are set by which to judge the adequacy of the Company's capital. The capital position is monitored against those benchmarks to ensure that sufficient capital is available to the Company. In the event that sufficient capital is not available, plans would be developed either to raise additional capital through, for example, subordinated loans, or to reduce the quantum of risk accepted thereby reducing the capital requirement through, for example, reinsurance or a change in investment strategy. If it becomes apparent that excess capital is available to the Company above its potential needs, plans would be developed to return such excess to shareholders.

Consistent with other insurers in the non-life industry, the FSA imposes two separate capital requirements on the Company of any significance: the Minimum Capital Requirement (MCR) as defined in the FSA regulations and reported publicly in the Company's Annual FSA return, and Individual Capital Guidance (ICG), which is entity specific and is derived using a more risk-related approach as set out in the FSA regulations. The ICG is calculated and updated by the FSA following its reviews on a regular basis of the Company's own Individual Capital Assessment (ICA).

The Company complied with all externally imposed capital requirements to which it was subject throughout the reporting period.

The Company had capital available of £133,899,000 (2008: £80,266,000), being net assets available to the Company.

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

The principal types of risk, which are detailed below, have been identified and risk appetite for each of these has been set based on the amount necessary to meet the Financial Service Authority's Individual Capital Assessment (ICA) capital requirements.

The Company recognises the critical importance of having efficient and effective risk management systems in place and these take the form of:

- Board and Executive committees with clear terms of reference
- A clear organisation structure with documented apportionment of responsibilities
- A uniform methodology of risk assessment, which is embedded within all companies in the LVFS Group so that they operate within agreed tolerances and with appropriate controls in place
- Regular reviews of risks by senior managers, where frequency of review is determined by the potential impact of the risk and its likelihood

## HIGHWAY INSURANCE COMPANY LIMITED

### NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

#### 5 Capital management and risk management and control (continued)

##### Insurance risk

Insurance risk is the risk that actual claims exceed the Company's insurance liabilities. It arises from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities. General insurance (GI) risk arises from the possibility of events which lead to significant claims in terms of quantity or value. These would include significant weather events, subsidence, substantial medical claims and major accidents on a single policy. Systems are in place to measure, monitor and control exposure to all these risks.

Motor business suffers from risks of substantial medical claims and major accidents on a single policy which can result in a large claim against one policy.

The Company has entered into Quota Share and Excess of Loss reinsurance contracts which reduce the Company's exposure to large claims.

i) The table below sets out the concentration of GI contract liabilities by type of contract.

	2009			2008		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Motor	371,485	(101,836)	269,649	324,052	(106,229)	217,823
Household	1,318	-	1,318	1,269	-	1,269
	372,803	(101,836)	270,967	325,321	(106,229)	219,092

ii) The table below sets out the impact on the GI claims provision and profits before tax for movements in key assumptions.

	Impact on profit before tax £m	Impact on GI claims provision £m
Sensitivity analysis for the change in the assumptions used in the GI claims provision		
Single storm event (1 in 200 year probability)	10	10
Increase in substantial medical claims by 10%	10	10
Increase in major accidents on a single policy	5	5

Motor business suffers from risks of substantial medical claims and major accidents on a single policy which can result in a large claim against one policy. The Company has entered into reinsurance contracts which reduce the Company's exposure to large claims, the reinsurance retention is £5m on a single policy.

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### 5. Capital management and risk management and control (continued)

The tables below reflect the cumulative incurred claims including both claims notified and IBNR for each successive accident year at each balance sheet date, together with the cumulative payments to date. The Company aims to maintain strong reserves in order to protect against adverse future claims experience and developments. As claims develop and the ultimate costs become more certain, adverse claims experiences are eliminated which results in a release from earlier accident years.

#### Analysis of claims development – gross of reinsurance

Accident year	2002 £000	2003 £000	2004 £000	2005 £000	2006 £000	2007 £000	2008 £000	2009 £000	Total £000
Initial estimate of gross provision	53,236	135,592	186,443	185,332	184,529	186,732	208,387	225,373	
One year later	59,370	142,293	179,817	191,271	179,987	196,802	243,594		
Two years later	55,748	131,910	179,586	179,300	179,697	198,483			
Three years later	51,812	121,188	169,009	171,572	179,460				
Four years later	49,379	116,269	167,018	166,653					
Five years later	51,737	117,182	165,215						
Six years later	52,065	116,385							
Seven years later	53,023								
<b>Current estimate of cumulative claims</b>	53,023	116,385	165,215	166,653	179,460	198,483	243,594	225,373	1,348,186
Cumulative payments to date	(50,448)	(109,089)	(153,071)	(149,895)	(154,324)	(149,321)	(153,589)	(86,068)	(1,005,805)
Liability recognised for 2002 to 2009 accident years	2,575	7,296	12,144	16,758	25,136	49,162	90,005	139,305	342,381
Liability recognised in respect of prior accident years									19,998
Claims handling provision									10,424
<b>Provision as at 31 December 2009</b>									<b>372,803</b>



# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### 5 Capital management and risk management and control (continued)

#### Analysis of claims development – net of reinsurance

Accident year	2002	2003	2004	2005	2006	2007	2008	2009	Total
	£000	£000	£000	£000	£000	£000	£000	£000	£000
Initial estimate of net provision	51,186	97,983	131,137	147,968	147,013	136,698	179,310	205,361	
One year later	53,267	105,894	129,780	141,447	129,289	151,532	191,179		
Two years later	49,716	99,605	129,114	126,098	143,012	151,542			
Three years later	47,660	93,489	127,858	129,688	141,621				
Four years later	46,052	98,517	122,428	127,975					
Five years later	46,612	90,224	122,009						
Six years later	46,749	88,283							
Seven years later	47,572								
<b>Current estimate of cumulative claims</b>	<b>47,572</b>	<b>88,283</b>	<b>122,009</b>	<b>127,975</b>	<b>141,621</b>	<b>151,542</b>	<b>191,179</b>	<b>205,361</b>	<b>1,075,542</b>
Cumulative payments to date	(45,493)	(87,503)	(117,928)	(120,727)	(123,043)	(119,505)	(128,834)	(79,026)	(822,059)
Liability recognised for 2002 -2009 accident years	2,079	780	4,081	7,248	18,578	32,037	62,345	126,335	253,483
Liability recognised in respect of prior years									7,060
Claims handling provision									10,424
<b>Provision as at 31 December 2009</b>									<b>270,967</b>

#### Market risk

Market risk is the risk of adverse impact due to fluctuations in bond yields, equity prices, interest rates, exchange rates or property prices. It arises due to fluctuations in liabilities arising from products sold and the value of investments held. The Company has defined policies and procedures in place to control the major components of market risk. Exposures to individual companies and to equity shares in aggregate are monitored in order to ensure compliance with the relevant regulatory limits for solvency purposes and with guidelines set for each fund. Securities held are primarily listed and traded on the UK and other recognised stock exchanges.

Limits on the Company's exposure to equities are defined both in aggregate terms and by geography, industry and counterparty. Tactical asset allocation meetings are held weekly, and strategic asset allocation meetings quarterly, to discuss investment return and concentration and to agree any changes required.

#### Interest rate risk

The Company monitors interest rate risk by calculating the mean duration of the investment portfolio and the liabilities issued. The mean duration is an indicator of the sensitivity of the assets and liabilities to changes in current interest rates. The mean duration of the liabilities is determined by means of projecting expected cash flows from the contracts using best estimates of mortality and voluntary terminations. The mean duration of the assets is calculated in a consistent manner.

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### 5. Capital management and risk management and control (continued)

#### 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. The Company's objective is to earn competitive relative returns by investing in a diverse portfolio of high quality liquid securities. The Company's holdings are diversified across industries and concentrations in any one company or industry are limited by parameters established by the Investment Committee.

#### Currency 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.

The Company also invests in a number of Collective Investment Schemes, which are predominantly 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.

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

As at 31 December 2009	Sterling £000	USD £000	Euro £000	Other £000	Total £000
<b>Financial assets at fair value through income</b>					
Shares, other variable yield securities and units in unit trusts	9,760	29,638	-	-	39,398
Debt and other fixed income securities	339,280	-	5,549	-	344,829
<b>Reinsurers' share of insurance contract liabilities</b>	105,614	-	-	-	105,614
<b>Receivables</b>					
Receivables arising out of broker insurance operations - intermediaries	26,695	-	2,180	-	28,875
Receivables arising out of reinsurance operations	8,422	-	-	-	8,422
Trade and other receivables	14,389	-	-	-	14,389
<b>Other assets</b>					
Cash and cash equivalents	72,794	2,025	14,295	-	89,114
<b>Insurance contracts</b>	(500,273)	-	(11,817)	-	(512,090)
<b>Financial liabilities</b>					
Subordinated note	-	-	(10,662)	-	(10,662)
<b>Amount under foreign exchange contracts</b>	31,232	(31,338)	-	-	(106)
<b>Total</b>	107,913	325	(455)	-	107,783

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### 5. Capital management and risk management and control (continued)

As at 31 December 2008	Sterling £000	USD £000	Euro £000	Other £000	Total £000
<b>Financial assets at fair value through income</b>					
Shares, other variable yield securities and units in unit trusts	2,688	52,377	6,852	3,568	65,485
Debt and other fixed income securities	142,705	-	8,652	-	151,357
Derivative financial instruments	2,205	974	680	132	3,991
<b>Reinsurers' share of insurance contract liabilities</b>	123,571	-	-	-	123,571
<b>Receivables</b>					
Receivables arising out of broker insurance operations - intermediaries	32,951	-	-	-	32,951
Receivables arising out of reinsurance operations	8,303	-	-	-	8,303
Trade and other receivables	3,788	-	-	-	3,788
<b>Other assets</b>					
Cash and cash equivalents	120,484	7,084	10,889	910	139,367
<b>Insurance contracts</b>	(426,192)	-	(8,727)	-	(434,919)
<b>Financial liabilities</b>					
Subordinated note	-	-	(11,380)	-	(11,380)
Derivative financial instruments	(3,080)	(1,201)	(770)	(673)	(5,724)
<b>Amount under foreign exchange contracts</b>	67,093	(57,916)	(5,525)	(3,652)	-
<b>Total</b>	<b>74,516</b>	<b>1,318</b>	<b>671</b>	<b>285</b>	<b>76,790</b>

### 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 2009 £000	Impact on equity 2009 £000	Impact on profit before tax 2008 £000	Impact on equity 2008 £000
<b>Interest rate risk</b>				
+ 50 basis points shift in yield curve	(3,520)	(2,534)	(1,246)	(891)
- 50 basis points shift in yield curve	3,520	2,534	1,267	906
<b>Currency risk</b>				
10% increase in euro exchange rate	-	-	2,933	2,097
10% decrease in euro exchange rate	-	-	(2,912)	(2,082)
10% increase in US dollar exchange rate	-	-	(3,498)	(2,501)
10% decrease in US dollar exchange rate	-	-	3,559	2,545
<b>Equity price risk (including derivatives)</b>				
10% increase in equity markets	3,954	2,847	3,506	2,486
10% decrease in equity markets	(3,954)	(2,847)	(4,180)	(2,958)

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### 5. Capital management and risk management and control (continued)

#### 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 amounts due from insurance intermediaries and policyholders.

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. A large proportion of the amounts due from reinsurance are balances due from other group undertakings, details of which are disclosed in note 32.

Exposure to insurance intermediaries risk is managed via a stringent credit policy. The Company's credit control function monitors the ageing and collectability of debtor balances, with credit evaluations performed on all relevant counterparties. The Company does not require collateral in respect of financial assets. Intermediary debt at 31 December 2009 was £28.9 million (2008: £33.0 million), all of which was not rated.

The Company also reduces its exposure to credit risk related to intermediaries by diversification through the use of a significant number of brokers.

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

	AAA	AA	A	BBB	Below BBB	Not rated	Total
	£000	£000	£000	£000	£000	£000	£000
<b>Credit risk exposure 2009</b>							
Debt and other fixed income securities	189,727	47,509	66,918	30,520	-	10,155	344,829
Reinsurance assets	18,646	8,101	70,918	-	-	7,949	105,614
<b>Total</b>	<b>208,373</b>	<b>55,610</b>	<b>137,836</b>	<b>30,520</b>	<b>-</b>	<b>18,104</b>	<b>450,443</b>
	AAA	AA	A	BBB	Below BBB	Not rated	Total
	£000	£000	£000	£000	£000	£000	£000
<b>Credit risk exposure 2008</b>							
Debt and other fixed income securities	131,540	11,386	5,328	474	-	2,629	151,357
Reinsurance assets	-	-	63,047	961	-	59,563	123,571
<b>Total</b>	<b>131,540</b>	<b>11,386</b>	<b>68,375</b>	<b>1,435</b>	<b>-</b>	<b>62,192</b>	<b>274,928</b>

The table below shows the aged analysis of the Company's past due and/or impaired assets:

	<31 days	31 to 60 days	61 to 90 days	>90 days	Total past due but not impaired	Past due and impaired	Total
	£000	£000	£000	£000	£000	£000	£000
<b>Age analysis of assets past due/ impaired 2009</b>							
Insurance receivables	3,352	(499)	(540)	1,402	3,715	2,428	6,143

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### 5. Capital management and risk management and control (continued)

#### 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 a 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.

The table below summarises the expected recovery or settlement of assets.

Maturity profile of financial assets	2009		Total
	Within 1 year	Over 1 year	
	£000	£000	£000
Deferred acquisition costs	17,194	-	17,194
Financial assets	57,927	326,300	384,227
Insurance receivables	37,297	-	37,297
Trade and other receivables	14,389	-	14,389
Reinsurance assets	41,512	64,102	105,614
Deferred tax asset	10,795	4,303	15,098
Current tax asset	6,048	-	6,048
Cash and cash equivalents	89,114	-	89,114
<b>Total assets</b>	<b>274,276</b>	<b>394,705</b>	<b>668,981</b>

The table below summarises the estimated maturity profile of the financial liabilities and equity of the company based on remaining undiscounted obligations.

	Within 1 year	1-3 years	3-5 years	Over 5 years	No term	Total
Maturity profile of financial liabilities 2009	£000	£000	£000	£000	£000	£000
Insurance contract liabilities	279,276	127,605	54,138	51,071	-	512,090
Financial liabilities	106	-	-	10,662	-	10,768
Insurance payables	3,703	-	-	-	-	3,703
Trade and other payables	8,521	-	-	-	-	8,521
Called up share capital					75,000	75,000
Capital reserve					110,000	110,000
Retained deficit					(51,101)	(51,101)
	<b>291,606</b>	<b>127,605</b>	<b>54,138</b>	<b>61,733</b>	<b>133,899</b>	<b>668,981</b>

## **HIGHWAY INSURANCE COMPANY LIMITED**

### **NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009**

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#### **5. Capital management and risk management and control (continued)**

##### **Strategic risk**

Strategic risk is the risk arising from the implementation of the agreed strategy. It includes risks arising from political, economic, sociological and technological changes, competitor actions and capital adequacy.

Executive management identifies strategic risks when drawing up business plans for approval by the Board and monitors these, ensuring that excess risk is reported to the Company Audit, Risk & Compliance Committee and Board.

The Company has not identified any current strategic risks.

##### **Group risk**

Group risk is the risk of contagion incurred from its membership of a group of firms. The Group Risk Committee oversees the management of such risks.

The Company has not identified any significant Group risks.

##### **Operational risk**

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

Senior managers are responsible for the identification, assessment, control and monitoring of operational risks and for reporting these to the Risk Committee in accordance with the Company's escalation criteria. Operational risks are assessed in terms of their probability and impact in accordance with Company policy.

##### **Fair value estimation**

Effective 1 January 2009, the company adopted the amendment to IFRS 7. This requires, for financial instruments held at fair value in the statement of financial position, disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1)
- 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 2)
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3)

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### 5. Capital management and risk management and control (continued)

The following tables present the Company's assets and liabilities measured at fair value at 31 December 2009

	Level 1 £000	Level 2 £000	Level 3 £000	2009 Total £000	2008 Total £000
<b>Fair value through income</b>					
Shares, other variable yield securities and units in unit trusts	9,760	-	29,638	39,398	65,485
Debt and other fixed income securities	126,778	218,051	-	344,829	151,357
	<b>136,538</b>	<b>218,051</b>	<b>29,638</b>	<b>384,227</b>	<b>216,842</b>
Forward exchange derivatives	-	(106)	-	(106)	(1,733)
	-	(106)	-	(106)	(1,733)

The fair value of financial instruments included in the Level 1 category are based on published quoted bid market prices in an active market at the year end date. A market is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Level 2 financial instruments are not traded in an active market, their fair value is determined using valuation techniques. These valuation techniques maximise the use of data from observable current market transactions where it is available, and assets for which pricing is obtained via pricing services, but where prices have not been determined in an active market, financial assets with fair values based on broker quotes.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3. The financial instruments in level 3 include £29,638,000.

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves
- The fair value of forward exchange contracts is determined using forward exchange rates at the statement of financial position date, with the resulting value discounted back to present value
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instrument

Movement in level 3 financial instruments measured at fair value

	At 1 January	Total gains/(loss) recorded in comprehensive income	Purchases	Sales	At 31 December
<b>Fair value through income.</b>					
Shares, other variable yield securities and units in unit trusts	46,748	(11,112)	16,468	(22,466)	29,638

### Sensitivities of level 3 investments

Changing the inputs for the Company's level 3 assets and liabilities would not significantly change the fair value.

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### 6. Net premium revenue

	2009 £000	2008 £000
Insurance contracts		
Premiums receivable	286,807	236,116
Change in unearned premium reserve	(29,689)	10,733
Premium revenue arising from insurance contracts issued	257,118	246,849
Reinsurance contracts		
Premiums payable	(7,988)	(38,200)
Change in unearned premium reserve	(13,564)	(8,109)
Premium revenue ceded to reinsurers on insurance contracts issued	(21,552)	(46,309)
<b>Net premium revenue</b>	<b>235,566</b>	<b>200,540</b>
Motor	232,797	198,401
Home	2,769	2,139
	<b>235,566</b>	<b>200,540</b>

### 7. Investment income

	2009 £000	2008 £000
Income from investments and cash and cash equivalents		
- Interest income	2,726	13,148
- Dividend income	7,210	889
	<b>9,936</b>	<b>14,037</b>

### 8. Net fair value gains/(losses) on financial assets held at fair value through income

	2009 £000	2008 £000
Gains and (losses) on financial assets at fair value through income		
- Debt securities	5,687	6,157
- Equity securities	(629)	(3,153)
- Derivative financial instruments	(4,608)	(14,664)
	<b>450</b>	<b>(11,660)</b>

Net fair value gains/(losses) on financial assets held at fair value through income include net realised gains of £5,335,000 (2008 £10,475,000 losses) and net unrealised losses of £4,886,000 (2008 £1,185,000 losses)



**HIGHWAY INSURANCE COMPANY LIMITED****NOTES TO THE ACCOUNTS  
FOR THE YEAR ENDED 31 DECEMBER 2009****9. Insurance claims and loss adjustment expenses**

	2009 £000	2008 £000
<b>Gross insurance claims</b>		
Current year claims and loss adjustment expenses	(217,949)	(223,277)
Movement in cost of prior year claims and loss adjustment expenses	(47,482)	(20,779)
	(265,431)	(244,056)
<b>Reinsurers share of gross insurance claims</b>		
Current year claims and loss adjustment expenses	31,147	42,627
Movement in cost of prior year claims and loss adjustment expenses	(4,393)	2,714
	26,754	45,341
<b>Net insurance claims</b>	<b>(238,677)</b>	<b>(198,715)</b>

**10. Finance costs**

	2009 £000	2008 £000
Interest payable to group undertakings	580	837
	580	837

**11. Other operating and administrative expenses**

	2009 £000	2008 £000
Investment management expenses and charges	800	1,516
Acquisition expenses	39,873	32,984
Movement in deferred acquisition costs	(4,152)	5,964
Administrative expenses	22,954	17,057
Other charges	-	677
	59,475	58,198

**12. Auditor's remuneration**

	2009 £000	2008 £000
Fees payable to Company's auditor for the audit of the Company's accounts	97	60
Fees payable to the Company's auditor for other services pursuant to legislation	33	-
	130	60

In 2008 fees paid to the Company's auditor, KPMG Audit Plc, for services other than the statutory audit of the Company were 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, were required to disclose non-audit fees on a consolidated basis

## HIGHWAY INSURANCE COMPANY LIMITED

### NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

#### 13. Directors' emoluments

During 2009 all Directors were remunerated by Liverpool Victoria Friendly Society and Highway Group Service Plc in respect of their executive roles within the Group (2008 the emoluments of the directors were paid by Highway Insurance Group Plc or Highway Group Services Plc and were included in the accounts of this Company as allocated costs within net operating expenses)

The aggregate amount of Directors' emoluments was as follows

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
a) Aggregate emoluments	<b>4,572</b>	<b>4,051</b>

b) There were no contributions to the money purchase pension scheme in 2009 (2008 £nil)

c) Emoluments of the Directors were as follows

	<b>Salaries</b>	<b>Bonuses</b>	<b>Other benefits</b>	<b>Compensation for loss of office</b>	<b>Total 2009</b>	<b>Total 2008</b>
	<b>£000</b>		<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
Highest paid Director	<b>474</b>	<b>405</b>	<b>118</b>	<b>-</b>	<b>997</b>	<b>1,033</b>
All Directors	<b>2,464</b>	<b>1,757</b>	<b>220</b>	<b>131</b>	<b>4,572</b>	<b>4,051</b>

Other benefits include contributions to funded unapproved retirement benefit schemes, company car allowances, medical, relocation and other benefits in kind or their equivalent monetary value

LVFS has made no contributions to personal pension arrangements during 2009 or 2008

d) Pension arrangements

S Daniels, P Bunker, P Horton, S Castle, J O'Roarke, R Rowney and K Abercromby are members of the LV= Employee Pension Scheme, which is a defined benefit scheme administered at group level

LVFS makes contributions to the LV= Employee Pension Scheme of 20.6% of pensionable salaries (2008. 20.6% of pensionable salaries less £6.1m) in respect of all permanent staff, including executive directors

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
Accrued pension at end of period		
All directors	<b>181</b>	<b>134</b>

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### 14. Income tax credit

#### a) Current year tax credit

	2009 £000	2008 £000
<b>Current year tax credit:</b>		
Group relief	6,591	74
Prior year adjustments	3,834	5,998
<b>Total current tax</b>	<b>10,425</b>	<b>6,072</b>
<b>Deferred tax credit</b>		
Deferred tax credit	9,238	9,551
Prior year adjustments	(3,673)	-
<b>Total deferred tax</b>	<b>5,565</b>	<b>9,551</b>
<b>Total income tax credit</b>	<b>15,990</b>	<b>15,623</b>

#### b) Reconciliation of tax credit

	2009 £000	2008 £000
Loss before tax	(52,357)	(54,126)
Loss multiplied by standard rate of corporation tax in the UK of 28% (2008 28.5%)	14,660	15,426
<b>Effects of:</b>		
Expenses not deductible for tax purposes	(8)	(190)
Losses offset against prior year taxable profits	-	(5,935)
Changes to the rate of Corporation Tax	-	126
Adjustments in respect of IFRS accounting	1,178	198
Adjustments to tax charge in respect of prior years	160	5,998
<b>Total income tax credit for the year</b>	<b>15,990</b>	<b>15,623</b>

### 15. Deferred acquisition costs

	2009 £000	Restated 2008 £000
At 1 January	15,948	21,912
Acquisition expenses deferred	39,873	34,922
Acquisition expenses adjustment	-	(4,699)
Liability adequacy test impairment	(2,907)	-
Amortisation	(35,720)	(36,187)
<b>At 31 December</b>	<b>17,194</b>	<b>15,948</b>

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

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### 16. Financial assets held at fair value through income

	2009 £000	2008 £000
<b>Fair value through income</b>		
Shares, other variable yield securities and units in unit trusts	39,398	65,485
Debt and other fixed income securities	344,829	151,357
	<b>384,227</b>	<b>216,842</b>

### 17. Derivative financial instruments

The Company utilises the following derivative instruments for hedging the effect of changes in exchange rate borrowings on its fixed rate bond portfolio. Fair values are estimated using current market interest rate data and are included in assets or liabilities as set out in the following table

	Contract/ notional amount £000	2009 Fair value - asset £000	Fair value - liability £000
Forward exchange derivatives	31,338	-	(106)
	<b>31,338</b>	<b>-</b>	<b>(106)</b>

	Contract/ notional amount £000	2008 Fair value - asset £000	Fair value - liability £000
Forward exchange derivatives	103,859	3,991	(5,724)
	<b>103,859</b>	<b>3,991</b>	<b>(5,724)</b>

### 18. Insurance receivables

	2009 £000	2008 £000
Receivables arising from insurance and reinsurance contracts		
- Due from intermediaries	28,875	32,951
- Due from reinsurers	8,422	8,303
	<b>37,297</b>	<b>41,254</b>

As at 31 December 2009 overdue insurance receivables arising from insurance contracts were provided at £2,428,000 (2008 £2,119,000)

### 19. Trade and other receivables

	2009 £000	2008 £000
Amount due from fellow group undertakings	6,806	1,304
Prepayments and accrued income	7,207	2,014
Other receivables	376	470
	<b>14,389</b>	<b>3,788</b>

# **HIGHWAY INSURANCE COMPANY LIMITED**

## **NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009**

### **20. Reinsurance assets**

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
Reinsurers' share of insurance liabilities	<b>105,614</b>	123,571
	<b>105,614</b>	123,571

Amounts due from reinsurers in respect of claims already paid by the Company on the contracts that are reinsured are included in insurance receivables

### **21 Deferred tax**

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
At 1 January	<b>9,533</b>	(18)
Amounts recorded in the statement of comprehensive income	<b>5,565</b>	9,551
At 31 December	<b>15,098</b>	9,533

Analysis of deferred taxation temporary differences

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
Advanced capital allowances	<b>865</b>	22
Taxable losses carried forward	<b>14,233</b>	9,511
	<b>15,098</b>	9,533

Future profits are expected against which the trading losses will be offset

### **22. Current tax**

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
At 1 January	<b>6,759</b>	(4,159)
Amounts recorded in the income statement	<b>3,834</b>	6,072
Tax (refund received)/paid	<b>(750)</b>	4,846
Group relief received	<b>(3,795)</b>	-
At 31 December	<b>6,048</b>	6,759

### **23. Cash and cash equivalents**

	<b>2009</b>	<b>2008</b>
	<b>£000</b>	<b>£000</b>
Bank balances	<b>4,463</b>	29,561
Short term bank deposits	<b>84,651</b>	109,806
<b>Cash and cash equivalents balance sheet</b>	<b>89,114</b>	139,367

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### 24. Insurance contracts

#### a) Analysis of insurance contracts

	2009			2008		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
General insurance claims liabilities	372,803	(101,836)	270,967	328,228	(106,229)	221,999
General insurance unearned premiums	139,287	(3,778)	135,509	109,598	(17,342)	92,256
	512,090	(105,614)	406,476	437,826	(123,571)	314,255

#### b) Movement in general insurance claims liabilities

	2009			2008		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
OCR	360,281	(117,412)	242,869	320,284	(102,250)	218,034
IBNR	(32,053)	11,183	(20,870)	(15,742)	(1,265)	(17,007)
Balance at 1 January	328,228	(106,229)	221,999	304,542	(103,515)	201,027
Movement in claims incurred in prior accident years	24,922	(6,745)	18,177	1,303	642	1,945
Claims incurred in the current accident year	225,370	(20,009)	205,361	225,293	(45,983)	179,310
Claims paid during the year	(202,810)	31,147	(171,663)	(202,910)	42,627	(160,283)
	47,482	4,393	51,875	23,686	(2,714)	20,972
OCR	409,624	(103,248)	306,376	360,281	(117,412)	242,869
IBNR	(36,821)	1,412	(35,409)	(32,053)	11,183	(20,870)
Balance at 31 December	372,803	(101,836)	270,967	328,228	(106,229)	221,999

#### c) Movement in general insurance unearned premiums

	2009			2008		
	Gross £000	Reinsurance £000	Net £000	Gross £000	Reinsurance £000	Net £000
Balance at 1 January	109,598	(17,342)	92,256	120,331	(25,451)	94,880
Premiums written in the year	286,807	(7,988)	278,819	236,116	(38,200)	197,916
Premiums earned during the year	(257,118)	21,552	(235,566)	(246,849)	46,309	(200,540)
Balance at 31 December	139,287	(3,778)	135,509	109,598	(17,342)	92,256

## HIGHWAY INSURANCE COMPANY LIMITED

### NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

#### 24. Insurance contracts (continued)

Details of the methodologies used for the premium and claims provisions for products administered on the main underwriting system are provided below. These products represent over 90% of the Company's liabilities.

##### Outstanding Claims Reserve (OCR)

The purpose of the OCR is to ensure adequate reserves are in place for known claims. It is calculated by aggregating the case reserves for all known claims and is calculated as part of the quarterly actuarial reserve review. However, the aggregated case reserves may be deemed to be over- or under-stated against the expected ultimate settlement cost of the known claims and this is allowed for in the IBNR calculation.

##### Incurred But Not Reported Reserve (IBNR)

The purpose of the IBNR reserve is to reflect the additional claims cost from claims incurred but not reported before the balance sheet date, known as 'pure IBNR' and the cost of any over- or under-statement in the OCR, known as Incurred But Not Enough Reported (IBNER).

IBNR is calculated as part of the quarterly actuarial reserve reviews using a combination of statistical / actuarial techniques.

These projections are performed on homogeneous groups of claim types. Otherwise, the projections would be prone to error from changes in mix by claim type. The claim types modelled are -

- Accidental Damage
- Fire & Theft
- Windscreen
- Third Party Property Damage
- Third Party Personal Injury

##### Unearned Premium Reserve (UPR)

The UPR is a provision for the claims and expenses attributable to the unexpired risk from business written prior to the balance sheet date. This is a system driven calculation based on a daily allocation method.

#### 25. Other financial liabilities

	2009 £000	2008 £000
Subordinated note	10,662	11,380
	10,662	11,380

€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%.

#### 26. Insurance payables

	2009 £000	2008 £000
Due to intermediaries	4	111
Due to reinsurers	3,699	1,641
	3,703	1,752

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### 27. Trade and other payables

	2009 £000	2008 £000
Insurance premium tax	3,307	2,598
Other payables	223	7,382
Accruals and deferred income	4,991	14,125
	<b>8,521</b>	<b>24,105</b>

### 28. Share capital

	2009 £000	2008 £000
<b>Authorised</b>		
Ordinary shares of £1 each	75,000	75,000
<b>Called up, allotted and fully paid</b>		
Ordinary shares of £1 each	75,000	75,000

### 29. Capital reserve

	2009 £000	2008 £000
Balance at 1 January	20,000	-
Additions	90,000	20,000
Balance at 31 December	<b>110,000</b>	<b>20,000</b>

The Company received the following capital contributions from Highway Insurance Group Plc during 2008 and 2009

22 December 2008	£20,000,000
24 February 2009	£10,000,000
25 September 2009	£10,000,000
19 October 2009	£25,000,000
26 November 2009	£10,000,000
18 December 2009	£35,000,000

These amounts are distributable in future periods, subject to the provisions of the Companies Act 2006

### 30. Retained deficit

	2009 £000	2008 £000
Balance at 1 January	(14,734)	23,205
Retained loss for the year	(36,367)	(38,503)
Share based payments	-	564
Balance at 31 December	<b>(51,101)</b>	<b>(14,734)</b>



# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### 31. Cash generated from operating activities

	2009 £000	2008 £000
<b>Loss before tax</b>	<b>(52,357)</b>	<b>(54,126)</b>
Investment income	(9,936)	(14,037)
(Gains)/losses on financial assets recorded in the statement of comprehensive income	(450)	11,660
Exchange (gains)/losses on financial assets recorded in the statement of comprehensive income	(718)	676
Finance costs	580	837
Purchase of investments at fair value through income	(334,085)	(199,502)
Sales of investments at fair value through income	175,457	239,920
<b>Non cash items</b>		
Expenses deferred during the year	(39,873)	(34,922)
Amortisation of deferred acquisition costs	35,720	40,886
Fair value charge on share based payments	-	564
<b>Changes in working capital</b>		
Decrease in reinsurance assets	17,957	5,395
Decrease/(increase) in insurance and other receivables	8,935	(5,721)
(Increase)/decrease in other prepayments and accrued income	(5,193)	2,563
Increase in insurance contract liabilities	77,171	12,953
Increase/(decrease) in insurance payables	1,951	(3,796)
(Decrease)/increase in trade and other payables	(15,582)	5,694
<b>Cash (used in)/generated from operating activities</b>	<b>(140,423)</b>	<b>9,044</b>

### 32. Related party transactions

The Company did not directly enter into transactions with key management personnel, all transaction have been settled by LVFS instead. All transactions are carried out on an arm's length basis. Details of significant transactions carried out during the year with related parties are as follows:

The following transactions have taken place between the Company and other Group companies:

	2009 £000	2008 £000
Reinsurance transactions with group undertakings (Highway Insurance Guernsey Limited)	13,115	34,581
Management charge from group undertakings (Liverpool Victoria Insurance Management Limited)	10,417	-
	<b>23,533</b>	<b>34,581</b>

Balances outstanding between the Company and other Group companies:

	2009 £000	2008 £000
Insurance balances receivable by the Company (Highway Insurance Guernsey Limited)	6,529	15,716
Other balances receivable by the Company (LVFS)	6,806	1,304
	<b>13,335</b>	<b>17,020</b>

## HIGHWAY INSURANCE COMPANY LIMITED

### NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

#### 33. Ultimate parent company

The ultimate parent company is Liverpool Victoria Friendly Society Limited, a UK incorporated Friendly Society registered under the Friendly Societies Act 1992

The immediate parent company is Highway Insurance Group Plc, a limited liability company, incorporated in the UK

Both the ultimate and immediate parent companies are registered at the below address

The largest and smallest company whose accounts this company is consolidated into is Liverpool Victoria Friendly Society Limited. 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

or at [www.lv.com/aboutus/report](http://www.lv.com/aboutus/report)

#### 34. IFRS 1 First time adoption of International Accounting Standards

##### a) Reconciliation of Statement of Comprehensive Income for the year ended 31 December 2008

	As reported UK GAAP £000	IFRS Reclassification £000	IFRS Adjustment £000	IFRS Restated £000
Insurance contract premium revenue	246,849	-	-	246,849
Insurance contract premium ceded to reinsurers	(46,309)	-	-	(46,309)
<b>Net premium revenue</b>	<b>200,540</b>	<b>-</b>	<b>-</b>	<b>200,540</b>
Investment income	8,337	5,700	-	14,037
Net fair value gains/(losses) on financial assets at fair value through income	(9,796)	(1,864)	-	(11,660)
Other income	707	-	-	707
<b>Total income</b>	<b>199,788</b>	<b>3,836</b>	<b>-</b>	<b>203,624</b>
Insurance claims and loss adjustment expenses	(244,056)	-	-	(244,056)
Insurance claims and loss adjustment expenses recoverable from reinsurers	45,341	-	-	45,341
<b>Net insurance claims</b>	<b>(198,715)</b>	<b>-</b>	<b>-</b>	<b>(198,715)</b>
Finance costs	-	(837)	-	(837)
Other operating and administrative expenses	(55,894)	(2,999)	695	(58,198)
<b>Total claims and expenses</b>	<b>(254,609)</b>	<b>(3,836)</b>	<b>695</b>	<b>(257,750)</b>
<b>Loss before tax</b>	<b>(54,821)</b>	<b>-</b>	<b>695</b>	<b>(54,126)</b>
Income tax credit	15,623	-	-	15,623
<b>Loss for the year</b>	<b>(39,198)</b>	<b>-</b>	<b>695</b>	<b>(38,503)</b>

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### b) Reconciliation of the Statement of Financial Position at 31 December 2008

	As reported UK GAAP £000	IFRS Reclassification £000	IFRS Adjustment £000	IFRS Restated £000
<b>Assets</b>				
Intangible assets	453	3,753	(4,206)	-
Tangible assets	3,753	(3,753)	-	-
Deferred acquisition costs	15,948	-	-	15,948
Investments	330,639	(330,639)	-	-
Financial assets				
- Fair value through profit or loss	-	216,842	-	216,842
- Derivative financial instruments	-	3,991	-	3,991
Insurance receivables	41,254	-	-	41,254
Trade and other receivables	20,129	(16,341)	-	3,788
Reinsurance assets	123,571	-	-	123,571
Deferred tax asset	-	9,533	-	9,533
Current tax asset	-	6,759	-	6,759
Cash and cash equivalents	30,673	108,694	-	139,367
<b>Total assets</b>	<b>566,420</b>	<b>(1,161)</b>	<b>(4,206)</b>	<b>561,053</b>
<b>Liabilities</b>				
Insurance contract liabilities	432,403	5,423	-	437,826
Financial liabilities				
- Derivative financial instruments	-	5,724	-	5,724
- Other financial liabilities	-	11,380	-	11,380
Insurance payables	1,752	-	-	1,752
Trade and other payables	47,793	(23,688)	-	24,105
<b>Total liabilities</b>	<b>481,948</b>	<b>(1,161)</b>	<b>-</b>	<b>480,787</b>
<b>Equity</b>				
Called up share capital	75,000	-	-	75,000
Capital reserve	20,000	-	-	20,000
Retained earnings	(10,528)	-	(4,206)	(14,734)
<b>Total equity</b>	<b>84,472</b>	<b>-</b>	<b>(4,206)</b>	<b>80,266</b>

Note 15 gives details of the reclassification of the 2008 balance

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### c) Reconciliation of Statement of Comprehensive Income for the year ended 31 December 2007

	As reported UK GAAP £000	IFRS Reclassification £000	IFRS Adjustment	IFRS Restated £000
Insurance contract premium revenue	248,170	-	-	248,170
Insurance contract premium ceded to reinsurers	(53,167)	-	-	(53,167)
<b>Net premium revenue</b>	<b>195,003</b>	<b>-</b>	<b>-</b>	<b>195,003</b>
Investment income	8,756	3,193	-	11,949
Net fair value gains/(losses) on financial assets at fair value through income	14,999	-	-	14,999
Other income	1,261	-	-	1,261
<b>Total income</b>	<b>220,019</b>	<b>3,193</b>	<b>-</b>	<b>223,212</b>
Insurance claims and loss adjustment expenses	(190,429)	-	-	(190,429)
Insurance claims and loss adjustment expenses recoverable from reinsurers	33,291	-	-	33,291
<b>Net insurance claims</b>	<b>(157,138)</b>	<b>-</b>	<b>-</b>	<b>(157,138)</b>
Finance costs		(668)		(668)
Other operating and administrative expenses	(42,996)	(2,525)	527	(44,994)
<b>Total claims and expenses</b>	<b>(42,996)</b>	<b>(3,193)</b>	<b>527</b>	<b>(45,662)</b>
<b>Profit before tax</b>	<b>19,885</b>	<b>-</b>	<b>527</b>	<b>20,412</b>
Income tax expense	(6,563)	-	-	(6,563)
<b>Profit for the year</b>	<b>13,322</b>	<b>-</b>	<b>527</b>	<b>13,849</b>

# HIGHWAY INSURANCE COMPANY LIMITED

## NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2009

### d) Reconciliation of the Statement of Financial Position at 31 December 2007

	As reported UK GAAP £000	IFRS Reclassification £000	IFRS Adjustment £000	IFRS Restated £000
<b>Assets</b>				
Intangible assets	566	4,335	(4,901)	-
Tangible assets	4,335	(4,335)	-	-
Deferred acquisition costs	21,912	-	-	21,912
Investments	326,195	(326,195)	-	-
Financial assets				
- Fair value through profit or loss	-	256,527	-	256,527
- Derivative financial instruments	-	483	-	483
Insurance receivables	26,047	-	-	26,047
Trade and other receivables	15,886	(98)	5,423	21,211
Reinsurance assets	128,966	-	-	128,966
Cash and cash equivalents	46,821	69,185	-	116,006
<b>Total assets</b>	<b>570,728</b>	<b>(98)</b>	<b>522</b>	<b>571,152</b>
<b>Liabilities</b>				
Insurance contract liabilities	419,450	-	5,423	424,873
Financial liabilities				
- Derivative financial instruments	-	2,596	-	2,596
- Other financial liabilities	-	8,791	-	8,791
Insurance payables	5,548	-	-	5,548
Current tax liability	-	4,159	-	4,159
Deferred tax liability	-	18	-	18
Trade and other payables	42,624	(15,662)	-	26,962
<b>Total liabilities</b>	<b>467,622</b>	<b>(98)</b>	<b>5,423</b>	<b>472,947</b>
<b>Equity</b>				
Called up share capital	75,000	-	-	75,000
Retained earnings	28,106	-	(4,901)	23,205
<b>Total equity</b>	<b>103,106</b>	<b>-</b>	<b>(4,901)</b>	<b>98,205</b>

### e) Notes to the IFRS reconciliations

#### i) Intangible assets

The Company has revisited its accounting policy on the capitalisation of intangible assets. Previously this was capitalised and amortised, but will now be fully expensed directly to reserves.

#### ii) Other adjustments

A number of adjustments required under IFRS relate primarily to presentational changes which have no underlying impact on the reserves. The movement in statement of comprehensive income reflects the move of unrealised losses to income. The movement in the statement of financial position reflects the movement in short term deposits that are less than three months to cash and cash equivalents.