00423930

Legal & General

LEGAL & GENERAL INSURANCE LIMITED

REPORT AND FINANCIAL STATEMENTS

2012

Legal & General Insurance Limited
Contents

Registered office

One Coleman Street
London EC2R 5AA

Registered in England and Wales No 00423930

Legal & General Insurance Limited
Directors' Report

The directors submit their annual report together with the audited financial statements of Legal & General Insurance Limited (the Company) for the year ended 31 December 2012

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

The Company continues to pursue a strategy focused on the housing marketplace, including leveraging the distribution relationships from the wider Legal & General proposition focused on the housing purchase event During the year we have enhanced our direct distribution capability and have continued to focus on improving our product proposition This has been further enhanced during the year by the launch of an enhanced Lifestyle product to replace our previous Mortgage Payment Protecton Insurance (MPPI) In addition we launched a Pet insurance product during the year through our new subsidiary, Legal and General Distribution Services Limited This product is currently underwritten by a third party

Market conditions remain challenging with business volumes impacted by low housing market transactions and the general uncertainty in economic conditions However we achieved 14% top line premium growth and believe there is still significant opportunity to increase premium income even in the current climate

Result for the year and dividend
The results of the Company shows a pre-tax profit of £35 7m (2011 £31 8m), details of which are set out on page 7 The result reflects the ongoing benefit of underwriting and claims management initiatives which offset the marginally worse than average weather experienced during the year The directors do not recommend the payment of a dividend (2011 £nil) this year

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

	2012	2011
Year end shareholders funds	£160m	£129m
Gross written premium	£349m	£305m
Profit/(Loss) before tax	£35 7m	£31 8m
Combined operating ratio	98%	93%

The combined operating ratio is $$\left[\frac{\text{Net incurred claims}}{\text{Net earned premiums}} + \frac{\text{Expenses + Net commission}}{\text{Net earned premiums}}\right] \times 100$$

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

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

Market and Economic Conditions
Competitor activity and changes in customer buying patterns would impact the achievement of sales targets A number of the Company's business channels have close links to the housing market Uncertainty in this market would restrict sales opportunities and adversely impact profitability The Company's strategic focus on household insurance means the Company has limited product diversification, and the payment protection products are at risk of being impacted by any downturn in economic conditions

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

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

Confidence In the Financial Services Sector and Specifically LGI
Events in the financial services sector outside the control of the Company and Legal & General Group (the Group) may impact earnings and profitability Historically such events have included
- Failings by competitors
- Actions by regulators within the industry
- Adverse performance of investment markets
- Adverse media coverage

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

Regulation and Legislation
There are a number of aspects to the way in which legislation and regulation impacts the Company's business
- Government fiscal policy
- Regulation of product design, marketing, sales and administration
- Prudential capital requirements
- The introduction of Solvency II and its impact on capital requirements and business risk management

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

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

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

Creditors
The Group agrees terms and conditions for its business transactions with suppliers Payment is made on these terms provided the supplier meets its obligations The Company has no trade creditors As at 31 December 2012, the average number of days of payments outstanding for the Legal & General Group of companies was 20 days (2011 36 days)

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

Legal & General Insurance Limited
Directors' Report

Directorate

The directors of the company who were in office during the year and up to the date of signing the financial statements were

J B Pollock (Chairman)
D A Finch
S P Harry (resigned 27 April 2012)
M A Lawler
M Holweger (appointed on 19 April 2012)
J Nickson (appointed 26 April 2012))
R A Regan (appointed 26 June 2012)
R J Byrne (appointed 3 July 2012)
C J Knight (appointed 21 August 2012)

Secretary

Legal & General Co Sec Limited

Directors' Indemnities and Insurance

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

Independent Auditors

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

Legal & General Insurance Limited
Directors' Report

Statement of Directors' Responsibilities

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

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

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

The directors are responsible for keeping 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

Each of the directors who held office at the date of approval of the directors report confirms that

(a) so far as the director is aware there is no relevant audit information of which the Company's auditors are unaware and

(b) 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 auditors are aware of such information

This confirmation is given in accordance with section 418(2) of the Companies Act 2006

By Order of the Board

J. Nickson

J Nickson
Director
1 March 2013

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

We have audited the financial statements of Legal & General Insurance Limited for the year ended 31 December 2012 which comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Cash Flow Statement, the Statement of Changes In Equity, 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 Statement of Directors' Responsibilities set out on page 5 the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

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

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

Opinion on financial statements
In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2012 and of its profit 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 matters prescribed by the Companies Act 2006
In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters which the Companies Act 2006 requires us to report to you if, in our opinion

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

Barnabas Wanstall (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
1 March 2013

Legal & General Insurance Limited
Statement of Comprehensive Income

For the year ended 31 December 2012

	Notes	2012 £'000	2011 £'000
Revenue			
Gross written premiums		348,662	304,752
Outward reinsurance premiums		(24,355)	(18,250)
Net change in provision for unearned premiums		(23,581)	(17,189)
Net premiums earned		300,726	269,313
Investment return - on financial investments at fair value through profit or loss	3	30,873	14,419
Total revenue		331,599	283,732
Expenses			
Claims and change in insurance liabilities		168,061	145,401
Reinsurance recoveries		(414)	(357)
Net claims and change in insurance liabilities	4	167,647	145,044
Acquisition costs	5	106,951	95,389
Finance costs	6	53	32
Other expenses	9	21,244	11,509
Total expenses		295,895	251,974
Profit before tax		35,704	31,758
Total tax expense	10	(8,131)	(8,014)
Total comprehensive income attributable to equity holders of the Company		27,573	23,744

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

Legal & General Insurance Limited 00423930

Statement of Financial Position

As at 31 December 2012

	Notes	2012 £'000	2011 £'000
Assets			
Investments in subsidiaries	14	300	2,608
Plant and equipment	13	7	56
Financial investments	15	324,096	291,103
Reinsurers' share of contract liabilities	19	11,482	8,814
Deferred acquisition costs	16	54,986	51,859
Receivables arising out of direct insurance operations - policyholders	17	65,927	59,701
- intermediaries	17	31,817	20,615
Amounts owed by group undertakings	17	30,835	7,697
Prepayments and other receivables	17	3,962	-
Cash and cash equivalents	18	16,625	19,293
Total assets		540,037	461,746
Equity			
Share capital	24	7,000	3,500
Share premium		96,053	96,053
Retained earnings	25	57,172	29,599
Total equity		160,225	129,152
Liabilities			
Insurance contract liabilities	19	282,966	244,348
Deferred tax liabilities	12	8,444	6,718
Corporation tax liabilities	11	6,400	6,077
Trade payables	21	28,616	24,022
Other payables	22	53,386	51,429
Total liabilities		379,812	332,594
Total equity and liabilities		540,037	461,746

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

The financial statements on pages 7 to 33 were approved by the directors on 1 March 2013 and were signed on their behalf by

J. Nickson

J Nickson
Director
1 March 2013

Legal & General Insurance Limited

Cash Flow Statement

As at 31 December 2012

	2012	2011
	£'000	£'000
Profit before tax	35,757	31,790
Adjustments for		
Depreciation	40	79
Loss on disposal of plant and equipment	10	-
Liquidation of investment in subsidiaries	2,608	-
Net fair value (gains)/losses on financial instruments	(15,479)	969
Dividend and interest income	(15,394)	(15,388)
Changes in operating assets and liabilities		
Net increase/(decrease) in insurance contract liabilities	38,618	(16,159)
Net increase in reinsurers' share of contract liabilities	(2,668)	(607)
Net decrease in deferred acquisition costs	(3,127)	(7,180)
Net decrease in other assets	(21,390)	(3,528)
Net increase in operational liabilities	10,051	1,777
Cash generated/(consumed) by operations	**29,026**	**(8,247)**
Interest received	15,173	15,674
Interest paid	(53)	(32)
Tax (paid)/received	(6,082)	3,378
Net cash flows from operating activities	**38,064**	**10,773**
Cash flows from investing activities		
Purchases of plant and equipment	(1)	(21)
Investment in subsidiaries	(300)	-
Purchases of financial instruments	(158,935)	(176,460)
Proceeds from the sale of financial instruments	141,642	169,935
Net (increase)/decrease in loans to Group undertakings	(23,138)	1,735
Net cash flows from investing activities	**(40,732)**	**(4,811)**
Net (decrease)/increase in cash or cash equivalents	(2,668)	5,962
Cash and cash equivalents at the beginning of the year	19,293	13,331
Cash and cash equivalents at the end of the year	16,625	19,293

Legal & General Insurance Limited

Statement of Changes in Equity

As at 31 December 2012

	Ordinary share capital £'000	Share premium £'000	Retained earnings £'000	Total £'000
Balance at 1 January 2012	3,500	96,053	29,599	129,152
Conversion of preference shares (see note 24)	3,500	-	-	3,500
Total comprehensive income for the year	-	-	27,573	27,573
Balance at 31 December 2012	7,000	96,053	57,172	160,225

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

Legal & General Insurance Limited
Notes to the Financial Statements

1 Accounting Policies

a) Basis of Preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB) as adopted by the European Union, and with those parts of the UK Companies Act 2006 applicable to companies reporting under IFRS The Company's financial statements also comply with IFRS and International Financial Reporting Interpretations Committee (IFRIC) interpretations as issued by the IASB The financial statements have been prepared under the historical cost convention on a going concern basis, and financial assets at fair value through profit and loss Accounting policies have been applied consistently, except in the instance where new policies have been adopted The Company is exempt from preparing consolidated financial statements by virtue of the Companies Act 2006, as its ultimate parent Company prepares publicly available consolidated financial statements that are deemed to satisfy the equivalence requirement of section 401 of the Companies Act 2006 The Company is domiciled in the United Kingdom

b) Use of estimates

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

IBNR

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

Tax balances

The current tax expense is based on the taxable profits for the year, after any adjustments in respect of prior years The judgement made, and uncertainties considered, in arriving at tax balances in the financial statements are discussed in Notes 10 to 12

c) General Insurance

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

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

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

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

Legal & General Insurance Limited
Notes to the Financial Statements

1 Accounting Policies (continued)

c) General Insurance (continued)

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

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

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

d) Reinsurance

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

e) Investments in subsidiaries

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

f) Financial Investments

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

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

The fair values of quoted financial investments are based on current bid prices If the market for a financial investment is not active, the Company establishes fair value by using valuation techniques such as recent arm's length transactions, consensus market pricing, reference to similar listed investments discounted cash flow models or option pricing models
Financial investments classified as HFT and FVTPL are measured at fair value with gains and losses reflected in the income statement Transaction costs are expensed as incurred

Legal & General Insurance Limited
Notes to the Financial Statements

1 Accounting Policies (continued)

f) Financial Investments (continued)

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

g) Investment Return

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

Investment income comprises interest, which is included on an accruals basis Interest income for financial assets which are not classified as FVTPL is recognised using the effective interest method

h) Tax

Current tax

Current tax comprises tax payable on current period profits adjusted for non-tax deductible or non-taxable items and any adjustments to tax payable in respect of previous periods Current tax is recognised in the income statement unless it relates to items which are recognised in other comprehensive income

Deferred tax

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

Tax rates

Following the 2012 Budget announcement, the rate of corporation tax is expected to reduce progressively to 22% by 1 April 2014 To calculate the current tax on profits, the rate of tax used is 24 5% (2011 26 5%), which is the average rate of corporation tax applicable for the year

The rate of tax used for the calculation of deferred tax is 23% (2011 25%) which is the rate of corporation tax that is expected to apply when the differences as mentioned above reverse This rate will apply from 1 April 2013 (2011 1 April 2012) onwards

i) Preference shares

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

j) Dividend recognition

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

k) Cash and cash equivalents

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

l) Plant and equipment

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

m) Share Capital

Shares are classified as equity when there is no obligation to transfer cash or other assets Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds net of tax Where any Group company purchases the Company's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity attributable to the Company's equity holders Where such shares are subsequently sold, reissued or otherwise disposed of any consideration received is included in equity attributable to the Company's equity holders, net of any directly attributable incremental transaction costs and the related income tax effects

Legal & General Insurance Limited
Notes to the Financial Statements

1 Accounting Policies (continued)

n) Standards, interpretations and amendments to published standards that are not yet effective

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

Amendment to IFRS 9, "Financial Instruments" on classification and measurement, issued in November 2009 (effective for annual periods commencing on or after 1 January 2015) This is the first part of a new standard on classification and measurement of financial assets that will replace IAS 39 IFRS 9 has two measurement categories amortised cost and fair value All equity instruments are measured at fair value A debt instrument is at amortised cost only if the entity is holding it to collect contractual cash flows and the cash flows represent principal and interest, otherwise it must be measured at fair value through profit or loss Further amendments to IFRS 9, dealing with financial liabilities, were published in October 2010 These include amortised cost accounting for most financial liabilities, with bifurcation of embedded derivatives The main impact of these is that in cases where the fair value option is taken for financial liabilities the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch The Company does not intend to early adopt this standard

Legal & General Insurance Limited
Notes to the Financial Statements

2 Profit/loss on ordinary activities before tax

	2012	2011
	£'000	£'000
Profit on ordinary activities before tax is stated after charging		
Depreciation of tangible assets	40	79
Auditors' remuneration (see below for further analysis)	317	346
	357	425
During the year fees were paid to the Company auditor for the following services		
Audit Services		
Fees payable to the Company auditor for the audit of the Company	152	139
Non Audit Services		
Fees payable to the Company auditor for other services		
- Other services pursuant to legislation	65	63
- All other services	100	144
Total	317	346

No gains or losses were recognised on buying reinsurance

3 Investment return

	2012	2011
	£'000	£'000
Investment income	15,394	15,388
Unrealised gains	15,784	3,815
Realised losses	(305)	(4,784)
	30 873	14 419

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

4 Net claims and change in insurance liabilities

	2012	2011
	£ 000	£'000
Claims paid		
- gross	155,978	179,457
- reinsurance recoveries	(700)	(458)
	155,278	178,999
Change in insurance liabilities		
- gross	12,083	(34,056)
- reinsurance recoveries	286	101
Net claims and change in insurance liabilities	167,647	145,044

5 Acquisition costs

	2012	2011
	£'000	£'000
Acquisition costs	110,078	102,568
Change in deferred acquisition costs	(3,127)	(7,179)
	106,951	95,389

Legal & General Insurance Limited
Notes to the Financial Statements

6 Finance costs

	2012	2011
	£'000	£'000
Interest payable to group undertakings	24	7
Preference share dividends	29	25
	53	32

7 Employee information

The company has no direct employees since they are employed by a fellow subsidiary of Legal & General Group Plc As a result the Company makes no direct contributions towards retirement benefits (2011 £nil)

8 Directors' emoluments

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

	2012	2011
	£'000	£'000
In respect of services as directors		
Aggregate emoluments	1,738	1 052
Aggregate money purchase contributions	138	94

No fees were paid by the Company to the directors
The emoluments received by the directors have been settled by a fellow group company, Legal & General Resources Limited and included within the recharge made to the Company

	2012	2011
	£'000	£'000
Highest paid director		
Emoluments	556	340
Money purchase contributions	35	35

9 Other expenses

	2012	2011
	£'000	£'000
Administrative expenses	22,732	12,608
Reinsurance commissions and profit participations	(1 961)	(1 540)
Investment management expenses	473	441
	21,244	11,509

10 Tax

	2012 £'000	2011 £'000
Current tax		
- Current tax for the year	6 344	6,094
- Adjustments in respect of prior years	61	54
Total current tax	6,405	6,148
Deferred tax		
- Movement in temporary differences	2,411	2,359
- Impact of reduction in UK corporate tax rate to 23% (2011 25%)	(685)	(493)
Total deferred tax	1,726	1,866
Total tax	8,131	8,014

The tax attributable to equity holders differs from the tax calculated at the standard UK corporation tax rate as follows

	2012 £'000	2011 £'000
Profit/(loss) before tax attributable to equity holders	35,704	31,758
Corporation tax at 24 5%/26 5%	8,748	8,416
Effects of		
Adjustments in respect of prior years	61	85
Income not subject to tax, such as dividends	7	6
Impact of reduction in UK corporate tax rate to 23% (2011 25%) on deferred tax balances	(685)	(493)
Tax attributable to equity shareholders	8,131	8 014

11 Current tax

	2012 £'000	2011 £'000
Tax due within 12 months	6,400	6,077
Tax due after 12 months	-	-
Current tax liabilities	6,400	6,077

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12 Deferred Tax

	Net tax assets/(liabilities) as at 1 January 2012	Tax credited/(charged) to the income statement	Net tax assets/(liabilities) as at 31 December 2012
	£'000	£'000	£'000
Excess of dep'n over capital allowances	493	(114)	379
Accounting provision	234	(107)	127
Claims equalisation reserve	(7 445)	(1 505)	(8 950)
Deferred tax assets/(liabilities)	(6 718)	(1 726)	(8 444)

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

13 Plant and equipment

	2012	2011
	£'000	£'000
Cost		
Balance at beginning of year	1,343	1,322
Additions	1	21
Disposals	(646)	-
Balance at end of year	698	1,343
Depreciation		
Balance at beginning of year	1,287	1,208
Charge for the year	40	79
Disposals	(636)	-
Balance at end of year	691	1,287
Closing net book value	7	56
Opening net book value	56	114

14 Investments in subsidiaries

	2012	2011
Shares in group undertakings	£'000	£'000
As at 1 January 2012	2,608	2,608
Liquidation of subsidiaries	(2,608)	-
Investment in new subsidiary	300	-
As at 31 December 2012	300	2,608

The subsidiaries of Legal & General Insurance Limited are listed below

Held directly by the business	Nature of business	Incorporated in
Legal & General Distribution Services Limited	Trading company	England & Wales

The following companies were liquidated during the year

Held directly by the business		
Southgate Associates Limited	Dormant company	England & Wales
Legal & General GI Computer Services Limited	Dormant company	England & Wales
Legal & General Healthcare Limited	Dormant company	England & Wales
Held indirectly through subsidiary undertakings		
Glanfield Securities Limited	Investment company	England & Wales
Legal & General Investment Trust Limited	Investment company	England & Wales
Bridge End Computers Limited	Dormant company	England & Wales

All subsidiaries are 100% owned and have a 31 December financial year end

15 Financial investments

	2012	2011
	£'000	£'000
Debt securities and other fixed income securities	317,412	284,641
Accrued interest	6,684	6 462
	324,096	291,103
Expected to be received within 12 months from the reporting date	16,980	12,951
Expected to be received after 12 months from the reporting date	307,116	278,152
	324,096	291,103

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

Fair value hierarchy

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

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

The levels of fair value measurement bases are defined as follows

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

15 Financial Investments (continued)

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

	Total	Level 1	Level 2	Level 3
As at 31 December 2012	£000	£'000	£'000	£'000
Debt securities and other fixed income securities	317,412	45,832	271,580	-
Accrued interest and rent	6,684	1 119	5,565	-
Total financial investments	324 096	46,951	277,145	-
As at 31 December 2011				
Debt securities and other fixed income securities	284,641	32,452	252,189	-
Accrued interest and rent	6,462	947	5,515	-
Total financial investments	291,103	33,399	257,704	-

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

There have been no significant transfers between levels in 2012 or 2011

16 Deferred acquisition costs

	Gross 2012 £'000	RI 2012 £'000	Gross 2011 £'000	RI 2011 £'000
As at 1 January	51,859	808	44,679	727
Acquisition costs movement in provision	3 127	304	7,180	81
As at 31 December	54 986	1,112	51,859	808
To be amortised within 12 months from the reporting date	54,986	1,112	51,859	808

17 Receivables

	2012 £'000	Restated 2011 £'000
Receivables arising out of direct insurance operations - policyholders	65,927	59,701
- intermediaries	31,817	20,615
Amounts owed by group undertakings	30,835	7,697
Prepayments and other receivables	3,962	-
	132,541	88,013
To be amortised within 12 months from the reporting date	132,541	80,316

Notes 17 and 22 have been restated for 2011 for the balance of £7,697,000 owed by group undertakings which was previously netted-off within payables Management believes that it is appropriate to disclose this balance in receivables There is no impact on the Statement of Comprehensive Income as a result of this restatement

Legal & General Insurance Limited
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18 Cash and cash equivalents

	2012	2011
	£'000	£'000
Cash at bank and in hand	7,435	8,261
Deposits with credit institutions	9,190	11,032
	16 625	19,293

19 Insurance contract liabilities

	Gross 2012	RI 2012	Gross 2011	RI 2011
	£'000	£'000	£'000	£'000
Provision for unearned premiums	178,889	(11,115)	152 354	(8,161)
Claims outstanding	104,077	(367)	91,994	(653)
	282,966	(11,482)	244,348	(8,814)

Expected net insurance claim cash flows

	Date of undiscounted cash flow					Total	Carrying value
	0-1 year	1-2 years	2-3 years	3-4 years	4-5+ years		
As at 31 December 2012	£'000	£'000	£'000	£ 000	£'000	£'000	£'000
Claims outstanding	69,872	11,947	7,413	4,697	9,781	103,710	103,710
As at 31 December 2011							
Claims outstanding	60,173	11,996	6,724	4,271	8,177	91,341	91,341

Insurance cash flows are based on the expected date of settlement

Movement in claims liabilities

	Gross 2012	RI 2012	Gross 2011	RI 2011
	£'000	£'000	£'000	£'000
As at 1 January	91 994	(653)	126,050	(754)
Claims arising	173,346	(482)	130,670	(431)
Claims paid	(155 084)	700	(179,457)	458
Adjustments to prior year liabilities	(6 179)	68	14,731	74
As at 31 December	104 077	(367)	91,994	(653)

Unearned premiums

	Gross 2012	RI 2012	Gross 2011	RI 2011
	£'000	£'000	£ 000	£'000
As at 1 January	152,354	(8,161)	134,457	(7,453)
Movement in provision	26,535	(2,954)	17,897	(708)
As at 31 December	178 889	(11,115)	152 354	(8,161)

All unearned premiums are expected to be earned within one year

20 Claims development tables

The tables below present changes in the historical provision for losses and loss adjustment expenses since 2008 and the provision for losses and loss adjustment expenses arising in each subsequent accident year

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

Gross of reinsurance

Accident year	2008 £'000	2009 £'000	2010 £'000	2011 £'000	2012 £'000	Total £'000
Estimate of ultimate claims costs						
- At end of accident year	190,786	163,609	173,748	123,883	166,725	818 751
- One year later	188,678	156,286	187,426	116,390		648 780
- Two years later	188,451	155,676	184,660			528 787
- Three years later	188 150	155 358				343 508
- Four years later	187,740					187,740
Estimate of cumulative claims	187,740	155,358	184,660	116,390	166,725	810,873
Cumulative payments	(186,001)	(151 844)	(173,204)	(110,745)	(94,807)	(716,601)
Outstanding claims provision	1,739	3,514	11,456	5,645	71,918	94 272
Outstanding claims provision for prior accident years						5 524
Claims handling provision						4,281
Total claims liabilities recognised in the balance sheet						104,077

Net of reinsurance

Accident year	2008 £'000	2009 £000	2010 £'000	2011 £'000	2012 £000	Total £'000
Estimate of ultimate claims costs						
- At end of accident year	189,192	162,364	173,111	123,451	166,373	814 491
- One year later	187 762	155 041	186,868	115,891		645,562
- Two years later	187,540	154 453	184 077			526,070
- Three years later	187,238	154,123				341,361
- Four years later	186,822					186 822
Estimate of cumulative claims	186,822	154,123	184 077	115,891	166 373	807 286
Cumulative payments	(185 087)	(150 618)	(172,634)	(110 311)	(94,703)	(713,353)
Outstanding claims provision	1,735	3 505	11 443	5 580	71 670	93,933
Outstanding claims provision for prior accident years						5,496
Claims handling provision						4 281
Total claims liabilities recognised in the balance sheet						103 710

21 Trade payables	2012	2011
	£'000	£'000
Payables arising from insurance and reinsurance contracts		
- agents, brokers and intermediaries	17,000	15,434
- reinsurers	11,616	8,588
	28,616	24,022

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

22 Other payables	2012	Restated 2011
	£'000	£'000
Amounts owed to group undertakings	44,387	38,979
Other payables	7,887	8,142
Reinsurance share of deferred acquisition costs	1,112	808
Preference shares (see note 24 for further detail)	-	3 500
	53,386	51,429

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

23 Contingent liabilities

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

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

24 Share capital

	2012 £'000
Authorised	
As at 31 December 2011 - 3,500,001 ordinary shares of £1 each	3,500
Authorised during the year - 3,499,999 ordinary shares of £1 each	3,500
As at 31 December 2012- 7,000 000 ordinary shares of £1 each	7,000
Issued and fully paid	
As at 31 December 2011 - 3,500,000 ordinary shares of £1 each	3,500
Conversion of 3,499,999 preference shares	3,500
As at 31 December 2012- 6,999,999 ordinary shares of £1 each	7,000

	2012 £'000
Preference Shares	
Authorised and issued, fully paid	
As at 31 December 2011 - 3,499,999 floating rate cumulative preference share of £1 each	3,500
Conversion to 3,499,999 ordinary £1 shares	(3,500)
As at 31 December 2012	-

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

Rights of preference shareholders

Total dividends for 2012 of £29,000 (2011 £25 000), were paid on 1 June and 22 November and ranked in priority to any other class of shares On winding-up redemption the preference shareholders were entitled, in priority to any other class of shares, to the capital repayment plus the proportion of dividends due No voting rights attached to the preference shares other than for a resolution for winding-up the Company or reducing its capital

Conversion of preference shares

On 22 November 2012, the authorised share capital of the Company was increased by 3,499,999 ordinary shares to 7,000,000 ordinary shares, and 3 499,999 preference shares were converted to ordinary shares The preference dividend was accrued and paid to the conversion date

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25 Retained earnings

	2012	2011
	£'000	£'000
Balance at 1 January	29,599	5,855
Retained profit for the year	27,573	23,744
Balance at 31 December	57,172	29,599

26 Holding company

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

Legal & General Group Plc is the parent undertaking of the largest group of undertakings to consolidate these financial statements at 31 December 2012 The consolidated financial statements of Legal & General Group Plc are available from the Company Secretary at the Registered Office, One Coleman Street, London, EC2R 5AA or on the Group website, www legalandgeneralgroup com

Legal and General Assurance Society Limited is the parent undertaking of the smallest group of undertakings to consolidate these financial statements t 31 December 2012 The consolidated financial statements of Legal & General Assurance Society Limited are available from the Company Secretary at the address above

27 Related party transactions

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

		2012	2011
		£'000	£'000
a	Investment management portfolio	460	428
b	Liquidity management	(64)	(18)
c	Group expense charges	48,055	46,977
d	Interest relating to preference dividends	29	25
e	Commission	3,372	784
f	Reinsurance premium	8,118	6,020

a Legal & General Investment Management (Holding) Limited (LGIM) manage the investment portfolio of the Company
b Interest charged/(credited) on loan facility by Legal & General Finance Plc at LIBOR plus 0 125%
c Legal & General Group recharges the Company for all direct costs associated with the business and an allocated proportion of centralised costs
d Preference dividend payable to Legal & General Assurance Society Limited
e The Company paid commission for business introduced by Legal & General Partnership Services Limited
f Reinsurance premium accepted by Legal and General Assurance Society Limited as part of a wider reinsurance treaty

There were no material transactions with key management personnel, being the Directors of the Company during the year, except for those relating to remuneration and shareholding, disclosed in note 8

27 Related party transactions (continued)

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

	2012	2011
	£000	£'000
Investment management portfolio	80	36
Liquidity management	(30,835)	(7 697)
Group expense charges	16,686	14,819
Interest relating to preference dividends	-	3
Commission	120	55
Reinsurance premium	3,798	2,766
Investment in subsidiaries	300	2,248
Payable to Legal & General Assurance Society Limited	27,493	19 052
Payable to Legal & General Distribution Services Limited	8	-
	17,650	31,282

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

28 Critical accounting estimates and judgements

General comments regarding assumptions and methodology

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

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

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

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

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

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

Projection of incurred claim amounts using the basic chain ladder method

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

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

28 Critical accounting estimates and judgements (continued)

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

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

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

Key drivers of Uncertainty in the Company's Reserves
Uncertainty in the Company s reserves can arise from a number of factors both internal and external For example
- The downturn in the economy could drive increased IBNR unemployment claims on the Accident Sickness and Unemployment product both in terms of increased frequency and increased claim duration
- On Household IBNR claims could increase due to the emergence of latent claims for example, in liability following an adverse court judgement or in subsidence as an improvement in the housing market leads to an increase in surveys and hence a greater number of cracks being noticed

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

This chosen level of uncertainty margin is translated into a percentage add-on to the reserves in respect of outstanding reported claims and IBNR for each class of business As at 31 December 2012 the margins were

10% for ASU
3% for Household plus £1,500 000
3% for Motor

As at 31 December 2011, the ASU margin was 15% This was reduced as at 31 December 2012 to reflect the reduced uncertainty resulting from greater economic stability The motor margin was 3% as at 31 December 2011 and is unchanged at 31 December 2012 An additional £1,500 000 was added to the household margin to reflect additional uncertainty around the treatment of recoveries and changes to the claims process The overall uncertainty remained within the 60-65th percentile range

Financial Impact of the Uncertainty
All figures in this section are based on the reserving exercise performed as at 31 December 2012

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28 Critical accounting estimates and judgements (continued)

Accident, Sickness and Unemployment
If non reinsurance backed IBNR claims increased by 50% the Company would need to hold an extra 12% of the best estimate reserve (assuming these claims have same average monthly benefit and duration as assumed in the best estimate calculation)

If all non reinsurance backed claimants were to claim for an extra month on top of what was assumed in the best estimate the Company would need to hold an extra 11% of the best estimate reserve

If these two events occurred at the same time the Company would need to hold an extra 23% of the best estimate However, the probability of this occurrence would be very small

The UK has recently experienced a double dip recession, and an unprecedented triple dip is considered possible, which could result in policyholders claiming on their policy for longer It could also result in a larger number of IBNR claims than we are reserving for For this reason a 10% margin does not look unreasonable in the current economic environment

Household
The table below shows how much extra the Company would need to hold in pounds if the number of IBNR claims increased by differing percentages The 3% margin plus £1 5m held in December 2012 amounted to £4 04m

Percentage increase in IBNR claims	Extra reserve required
10%	£703 250
20%	£1,406 501
30%	£2,109,751
40%	£2,813,001
50%	£3,516,251
60%	£4 219 502

The table shows that the margin would have been enough to cover just over a 57% increase in IBNR claims

Figures for Motor and Mortgage Payment Protection are not material given the total IBNR of £149,000 as at 31 December 2012

29 Risk management and control

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

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

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

Insurance risk

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

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

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

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

Market risk

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

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

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

29 Risk management and control (continued)

Credit risk

The Company's exposure to credit risk includes

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

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

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

	AAA £'000	AA £'000	A £'000	BBB £'000	BB & below £'000	Unrated £'000	Total £'000
As at 31 December 2012							
Government securities	13,934	-	-	-	-	-	13,934
Other fixed rate securities	80,633	21,795	102,860	95,684	-	-	300,972
Variable rate securities	-	2 508	-	-	-	-	2,508
Total debt securities	94,567	24,303	102,860	95,684	-	-	317,414
Accrued interest	2,172	325	2,166	2,021	-	-	6,684
Cash and cash equivalents	-	9,190	7,435	-	-	-	16,625
Financial assets	96,739	33 818	112,461	97,705	-	-	340,723
Reinsurers share of contract liabilities	53	5,746	5,323	360	-	-	11,482
Other assets	-	-	30,835	-	-	156,997	187,832
Total	96,792	39,564	148,619	98,065	-	156,997	540,037

	AAA £'000	AA £'000	A £'000	BBB £ 000	BB & below £'000	Unrated £'000	Total £'000
As at 31 December 2011							
Government securities	3 055	-	-	-	-	-	3,055
Other fixed rate securities	81,489	18,467	93,422	87,809	-	-	281,187
Variable rate securities	399	-	-	-	-	-	399
Total debt securities	84,943	18,467	93,422	87,809	-	-	284,641
Accrued interest	2,037	250	2,326	1,849	-	-	6,462
Cash and cash equivalents	4,546	6,486	-	-	-	8,261	19,293
Financial assets	91,526	25,203	95,748	89,658	-	8,261	310 396
Reinsurers' share of contract liabilities	43	4,001	4,365	405	-	-	8,814
Other assets	-	-	7,697	-	-	134 839	142,536
Total	91,569	29 204	107,810	90 063	-	143,100	461,746

for claims in excess of £1m and terrorism cover is in place to cover terror related claims in excess of £0 75m

29 Risk management and control (continued)

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

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

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

The following aspects of liquidity risk are relevant to the Company

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

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

Contingent liquidity risk - the risk from the occurrence of high impact events for which no provision has been made in liquidity forecasts due to the events having an extremely low probability of occurrence Such events giving rise to contingent liquidity risk may include
- External events, particularly those of a catastrophic nature which may give rise to significant number of claims or policy withdrawals requiring settlement and
- A significant failure in internal controls either resulting in direct financial loss or the need to pay redress to customers who may have suffered disadvantage as a result of failure

Operational risk
The Company aims to implement cost-effective controls to reduce operational risk exposures Control performance is monitored regularly and weaknesses or failures reported, with appropriate action plans The Risk and Compliance Committee reviews operational risk exposures and controls monthly

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

The principal products of the Company are

- **Household** These contracts provide cover in respect of householders' homes, investment properties, contents, personal belongings and incidental liabilities which they may incur as a property owner occupier and individual Exposure is normally limited to the rebuilding cost of the home the replacement cost of belongings and a policy limit in respect of liability claims The Company uses reinsurance to manage the exposure to an accumulation of claims arising from any one incident, usually severe weather The catastrophe cover runs from 1 July to 30 June and reinsures the Company for losses between £36m and £360m (2011/2012 £30m and £265m) for a single weather event A single household policy can result in a large liability claim To mitigate the risk accident excess of loss reinsurance is in place for claims in excess of £0 75m (2011 £0 75m) A further reinsurance treaty protects against individual large losses on the company s social housing portfolio, for claims between £1m and £8m and terrorism cover is in place to cover terror related claims in excess of £0 75m

29 Risk management and control (continued)

- **Accident, Sickness and Unemployment** These contracts provide cover in respect of continuing payment liabilities incurred by customers when they are unable to work as a result of accident sickness or unemployment They protect predominantly mortgage payments Exposure is limited to the monthly payment level selected by the customer sufficient to cover the payment and associated costs up to the duration limit specified in the policy usually 12 months

- **Motor** (in run-off) These contracts provide cover in respect of customers private cars and their liability to third parties in respect of third party damage Exposure is normally limited to the replacement value of the vehicle and a policy limit in respect of third party property damage Exposure to third party bodily injury is unlimited in accordance with the statutory requirements The motor book continues in run-off the final policy having expired in August 2007 this is expected to takeseveral years

- **Domestic Mortgage Indemnity** These contracts (primarily in run-off) protect a mortgage lender should an insured property be repossessed and subsequently sold at a loss Since 1993 the contract has included a maximum period of cover of ten years and a cap on the maximum claim For business accepted prior to 1993 cover is unlimited and lasts until the insured property is remortgaged or redeemed

Key risk factors

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

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

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

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

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

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29 Risk management and control (continued)

Sensitivity analysis

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

	Impact on pre tax profit net of reinsurance 2012 £'000	Impact on equity net of reinsurance 2012 £'000	Impact on pre-tax profit net of reinsurance 2011 £ 000	Impact on equity net of reinsurance 2011 £ 000
Sensitivity test				
Single storm event with 1 in 200 year probability	(62 850)	(47,452)	(89,767)	(66,427)
Subsidence event - worst claim ratio in last 30 years	(49,641)	(37 479)	(41,149)	(30 450)
Economic downturn	(41 429)	(31,279)	(42,964)	(31,794)
5% decrease in overall claims ratio	7,823	5,906	8 851	6,550
5% surplus over claims liabilities	5 201	3,926	4,567	3,380

For any single event with claims in excess of £36m (2011 £30m) but less than £360m (2011 £265m), the ultimate cost to the Company would be £36m (2011 £30m) The impact of a 1 in 500 year modelled windstorm and coastal flood event would exceed the catastrophe cover by approximately £180m (2011 £192m)

IGD sensitivity analysis

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

	Impact on surplus capital 2012 £ 000	Impact on surplus capital 2011 £ 000
Sensitivity test		
100bps increase in interest rates	(10 000)	(7 500)
100bps decrease in interest rates	10,000	7 500
100bps increase in credit spreads	(9,500)	(7,400)

Capital

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

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