

00423930



**LEGAL & GENERAL INSURANCE LIMITED**

**REPORT AND FINANCIAL STATEMENTS**

**2013**

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## **Legal & General Insurance Limited**

### **Contents**

#### **Page**

2	Strategic Report
5	Directors' Report
7	Independent Auditors' Report
9	Statement of Comprehensive Income
10	Statement of Financial Position
11	Cash Flow Statement
12	Statement of Changes in Equity
13	Notes to the Financial Statements

#### **Registered office**

One Coleman Street  
London EC2R 5AA

Registered in England and Wales No. 00423930

## Legal & General Insurance Limited Strategic Report

### Principal activity

The Company is an insurance company authorised in the UK by the Prudential Regulation Authority, and regulated by the Financial Conduct Authority ('FCA') and the Prudential Regulation Authority ('PRA'). The principal activity of the Company is the transaction of general insurance business in the personal sector marketplace, specifically relating to risk covers for household and short term income protection insurance.

### Business review

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. Focus on our direct sales proposition has driven a 40% increase in top line premium with the Company being the fastest growing home insurer in direct sales in 2013.

During the year we have also continued to focus on improving our overall product proposition and a further £1,700,000 investment was made in our subsidiary, Legal & General Distribution Services Limited, to support the launch of a motor insurance product proposition.

Market conditions remain challenging with business volumes impacted by low housing market transactions, although the upturn seen in the latter part of the year is seen as promising, and the general uncertainty in economic conditions. However, we maintained the growth seen in recent years and achieved 8% top line premium growth and believe there is still significant opportunity to increase premium income within the current competitive market.

### Result for the year and dividend

The results of the Company shows a pre-tax profit of £47,180,000 (2012: £35,704,000), details of which are set out on page 9. The result reflects the ongoing benefit of underwriting and claims management initiatives in addition to the generally favourable weather experience during the year. The directors do not recommend the payment of a dividend (2012: £nil) this year.

### Financial key performance indicators

In addition to the pre-tax performance noted above, other key financial measures monitored by the Board of Directors (the 'Board') are as follows:

	2013	2012
Year end shareholders funds (£'000)	197,782	160,225
Gross written premium (£'000)	375,026	348,662
Combined operating ratio	87%	98%
The combined operating ratio is:	$\frac{(\text{Net Incurred Claims} + \text{Expenses} + \text{Net Commission})}{\text{Net Premiums Earned}}$	

### Other key performance indicators

The Board also monitor a number of non-financial key performance measures, including:

	2013	2012
Inforce Policies	1,960,765	1,635,408
Corporate Social Responsibility Days	486	271
Average monthly reportable complaints (% of inforce policies)	0.007	0.009

### Future developments

Going forward the Company will continue to evolve its strategy in the household insurance marketplace, focusing on the development of sustainable profitable relationships and strong management of loss ratios through improved underwriting and claims management techniques. The Company is managed within the Insurance division of Legal & General Assurance Society which brings together all personal protection lines business. As well as providing a more seamless service for customers, it is anticipated that this should provide additional opportunities for the sale of general insurance products to existing Legal & General Group customers.

## **Legal & General Insurance Limited Strategic Report (continued)**

### **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 30.

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 income 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 7 to 1 in 200 year event. However, 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 the Company**

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; and
- 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; and
- 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.

**Legal & General Insurance Limited**  
**Strategic Report (continued)**

**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. This 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 levels, the financial failure of a third party or provision of inadequate service could impact the reputation and regulatory compliance of the Company.

By Order of the Board

A handwritten signature in black ink, appearing to read 'Andrew D. Fairhurst'.

A Fairhurst  
for and on behalf of Legal & General Co Sec Limited  
Company Secretary  
3 March 2014

## **Legal & General Insurance Limited Directors' Report**

The directors present their annual report together with the audited financial statements of Legal & General Insurance Limited (the 'Company') for the year ended 31 December 2013.

### **Result for the year and dividend**

The results of the Company shows a pre-tax profit of £47,180,000 (2012: £35,704,000), details of which are set out on page 9. The result reflects the ongoing benefit of underwriting and claims management initiatives in addition to the generally favourable weather experience during the year. The directors do not recommend the payment of a dividend (2012: £nil) this year.

### **Post Balance Sheet Events**

The adverse weather conditions experienced in December 2013, have continued into January and February 2014. This has resulted in storm and flood damage to property across the UK. The Company has and will continue to support insured householders who have experienced loss or damage as a result of the inclement weather.

Although it is too early to assess the final financial impact of the claims arising as a result of this recent weather, the Directors are satisfied that the Company has sufficient resources to manage the uplifted claims experience.

### **Financial Risk Management**

The Company uses 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 financial position or profitability, except as discussed previously in the Strategic Report.

### **Political Donations**

The Company made no political donations and incurred no political expenditure during the year.

### **Directorate**

The directors of the Company who were in office during the year and up to the date of signing the financial statements are shown below:

J.B. Pollock (Chairman)  
D.A. Finch  
M.A. Lawler (resigned 21 November 2013)  
M. Holweger  
J. Nickson  
R. A. Regan (resigned 17 January 2014)  
R. J. Byrne  
C. J. Knight  
D. Buckley (appointed 25 July 2013, resigned 21 November 2013)

### **Company 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, and PricewaterhouseCoopers LLP will therefore continue in office.

## **Legal & General Insurance Limited**

### **Directors' Report (continued)**

#### **Statement of Directors' Responsibilities**

The directors are responsible for preparing the Strategic Report, 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 prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) 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 accounting estimates that are reasonable and prudent;
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union 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.

#### **Statement as to Disclosure of Information to Auditors**

Each of the directors, who held office, at the date the Director's report is approved, 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 that information.

By Order of the Board



A Fairhurst  
for and on behalf of Legal & General Co Sec Limited  
Company Secretary  
3 March 2014

## **Legal & General Insurance Limited**

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

#### **Report on the financial statements**

##### **Our opinion**

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2013 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

This opinion is to be read in the context of what we say below.

##### **What we have audited**

The financial statements for the year ended 31 December 2013 which are prepared by Legal & General Insurance Limited comprise:

- Statement of Financial Position;
- Statement of Comprehensive Income;
- Cash Flow Statement;
- Statement of Changes in Equity; and
- related notes.

The financial reporting framework that has been applied in their preparation comprises applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

##### **What an audit of financial statements involves**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the Legal & General Insurance Limited Report & Financial Statements 2013 to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

##### **Opinion on matter prescribed by the Companies Act 2006**

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

##### **Other matters on which we are required to report by exception**

###### **Adequacy of accounting records and information and explanations received**

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been, 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.

We have no exceptions to report arising from this responsibility.



## **Legal & General Insurance Limited**

### **Independent Auditors' Report to the Members of Legal & General Insurance Limited (continued)**

#### **Directors' remuneration**

Under the Companies Act 2006 we are required to report if, in our opinion, certain disclosures of directors' remuneration specified by law have not been made. We have no exceptions to report arising from this responsibility.

#### **Responsibilities for the financial statements and the audit**

##### **Our responsibilities and those of the directors**

As explained more fully in the Directors' Responsibilities Statement set out on page 6, 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 ISAs (UK & 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 whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.



Barnabas Wanstall (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London  
8 March 2014

**Legal & General Insurance Limited**  
**Statement of Comprehensive Income**  
For the year ended 31 December 2013

	Notes	2013 £'000	2012 £'000
<b>Revenue</b>			
Gross written premiums		375,026	348,662
Outward reinsurance premiums		(23,023)	(24,355)
Net change in provision for unearned premiums		(15,630)	(23,581)
<b>Net premiums earned</b>		<b>336,373</b>	<b>300,726</b>
Investment return - on financial investments at fair value through profit or loss	3.	5,176	30,873
<b>Total revenue</b>		<b>341,549</b>	<b>331,599</b>
<b>Expenses</b>			
Claims and change in insurance liabilities		153,759	168,061
Reinsurance recoveries		(477)	(414)
<b>Net claims and change in insurance liabilities</b>	4.	<b>153,282</b>	<b>167,647</b>
Acquisition costs	5.	113,195	106,951
Finance costs	6.	29	53
Other expenses	9.	27,863	21,244
<b>Total expenses</b>		<b>294,369</b>	<b>295,895</b>
<b>Profit before tax</b>		<b>47,180</b>	<b>35,704</b>
Total tax expense	10.	(9,623)	(8,131)
<b>Profit for the year and total comprehensive income</b>		<b>37,557</b>	<b>27,573</b>

All activities of the Company are classified as continuing.

The profit for the year and total comprehensive income is entirely attributable to the equity holders of the Company.

The notes on pages 13 to 33 form an integral part of the financial statements.

**Legal & General Insurance Limited**

**Statement of Financial Position**

As at 31 December 2013

	Notes	2013 £'000	2012 £'000
<b>Assets</b>			
Investments in subsidiaries	15.	2,000	300
Plant and equipment	14.	503	7
Intangible assets	13.	6,287	-
Financial investments	16.	348,778	324,096
Reinsurers' share of contract liabilities	20.	11,481	11,482
Deferred acquisition costs	17.	60,064	54,986
Receivables arising out of direct insurance operations - policyholders	18.	72,391	65,927
- intermediaries	18.	30,254	31,817
Amounts owed by group undertakings	18.	2,518	30,835
Prepayments and other receivables	18.	5,299	3,962
Cash and cash equivalents	19.	32,782	16,625
<b>Total assets</b>		<b>572,357</b>	<b>540,037</b>
<b>Equity</b>			
Share capital	25.	7,000	7,000
Share premium		96,053	96,053
Retained earnings	26.	94,729	57,172
<b>Total equity</b>		<b>197,782</b>	<b>160,225</b>
<b>Liabilities</b>			
Insurance contract liabilities	20.	297,230	282,966
Deferred tax liabilities	12.	9,719	8,444
Current tax liabilities	11.	8,348	6,400
Trade payables	22.	19,803	28,616
Other payables	23.	39,475	53,386
<b>Total liabilities</b>		<b>374,575</b>	<b>379,812</b>
<b>Total equity and liabilities</b>		<b>572,357</b>	<b>540,037</b>

The notes on pages 13 to 33 form an integral part of the financial statements.

The financial statements on pages 9 to 33 were approved by the Board of directors on 3 March 2014 and were signed on their behalf by



J Nickson  
Director

Company Registration Number: 00423930.

# **Legal & General Insurance Limited**

## **Cash Flow Statement**

For the year ended 31 December 2013

	2013	2012 (restated note 1)
	£'000	£'000
<b>Cash flows from operating activities</b>		
<b>Profit before tax</b>	47,180	35,704
<b>Adjustments for:</b>		
Depreciation	5	40
Loss on disposal of plant and equipment	-	10
Liquidation of investment in subsidiaries	-	2,608
Net fair value losses/ (gains) on financial instruments	10,595	(15,479)
Dividend and interest income	(15,771)	(15,394)
Interest paid	29	53
<b>Changes in operating assets and liabilities:</b>		
Net increase in insurance contract liabilities	14,264	38,618
Net decrease/ (increase) in reinsurers' share of contract liabilities	1	(2,668)
Net increase in deferred acquisition costs	(5,078)	(3,127)
Net increase in other assets	(6,238)	(21,390)
Net (decrease)/ increase in operational liabilities	(22,724)	10,051
Purchases of financial instruments	(221,036)	(158,935)
Proceeds from the sale of financial instruments	185,443	141,642
<b>Cash (outflow)/ Inflow generated by operations</b>	<b>(13,330)</b>	<b>11,733</b>
Interest received	16,087	15,173
Interest paid	(29)	(53)
Tax paid	(6,400)	(6,082)
<b>Net cash flows (outflow)/ Inflow from operating activities</b>	<b>(3,672)</b>	<b>20,771</b>
<b>Cash flows from investing activities</b>		
Purchases of plant and equipment	(501)	(1)
Purchases of intangible assets	(6,287)	-
Investment in subsidiaries	(1,700)	(300)
Net decrease/ (increase) in loans to Group undertakings	28,317	(23,138)
<b>Net cash flows Inflow/ (outflow) from investing activities</b>	<b>19,829</b>	<b>(23,439)</b>
Net increase/ (decrease) in cash or cash equivalents	16,157	(2,668)
Cash and cash equivalents at the beginning of the year	16,625	19,293
<b>Cash and cash equivalents at the end of the year</b>	<b>32,782</b>	<b>16,625</b>

The notes on pages 13 to 33 form an integral part of the financial statements.

**Legal & General Insurance Limited**  
**Statement of Changes in Equity**  
For the year ended 31 December 2013

	Ordinary share capital £'000	Share premium £'000	Retained earnings £'000	Total £'000
Balance at 1 January 2013	7,000	96,053	57,172	160,225
Profit for the year and total comprehensive income	-	-	37,557	37,557
Balance at 31 December 2013	7,000	96,053	94,729	197,782

	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 6)	3,500	-	-	3,500
Profit for the year and total comprehensive income	-	-	27,573	27,573
Balance at 31 December 2012	7,000	96,053	57,172	160,225

The notes on pages 13 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, as modified by the revaluation of financial assets at fair value through profit and loss. Accounting policies have been applied consistently to all years presented except as otherwise stated.

A reclassification has been made in 2013 to the Cash Flow Statement. Purchases of and proceeds from the sale of financial instruments have been included in cash generated from operations in 2013; a reclassification from cash flows from investing activities in 2012 to ensure consistency with the Statement of Comprehensive Income. This reclassification had no net impact on the net increase/ decrease in cash or cash equivalents presented, but resulted in a decrease to cash generated by operations and net cash flows from operating activities, and an increase in net cash flows from investing activities of £17,293,000 in the 2012 comparatives.

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 (also referred to as the balance sheet), 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 estimation of incurred but not reported ('IBNR') estimates within insurance contract liabilities. The basis of accounting for these liabilities is set out in (c) below and the significant judgements used in determining the estimate is outlined in note 29 to the financial statements.

##### **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 as gross written premium. 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 gross written premium 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. All other costs are recognised as expenses when incurred.

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

## **Legal & General Insurance Limited**

### **Notes to the Financial Statements**

#### **1. Accounting Policies (continued)**

##### **c) General Insurance (continued)**

Provision is made at the balance sheet date for the estimated cost of claims and related insurance recoveries incurred but not settled at that 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 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. Outward reinsurance premiums are recognised in the same accounting period as the related premiums for the direct or inward insurance business being reinsured. Reinsurance assets include balances due from reinsurers for paid and unpaid losses, 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 subsidiary at each balance sheet date where there has been an indication that impairment has occurred. If the carrying value of the subsidiary undertaking is impaired, the carrying value is reduced through a charge to the statement of comprehensive income.

##### **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'.

The fair values of quoted financial investments are based on bid prices, which management believe to be representative of fair value. 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)

On 1 January 2013 the Company adopted IFRS 13 'Fair Value Measurement'. This Standard defines fair value, sets out in a single IFRS a framework for measuring fair value, and requires disclosure about fair value measurements. The main impact on the Company for the full year lies in the expansion of the fair value disclosure requirements.

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

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 2013 Budget announcement, the rate of corporation tax is expected to reduce progressively to 20% by 1 April 2015. To calculate the current tax on profits, the rate of tax used is 23.25% (2012: 24.5%), which is the average rate of corporation tax applicable for the year.

The rate of tax used for the calculation of deferred tax is 20% (2012: 23%), which is the rate of corporation tax that is expected to apply when the differences as mentioned above reverse. This rate will apply from 1st April 2015 (2012: 1st April 2013) 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 and other short-term highly liquid investments with original maturities of three months or less.

##### l) Intangible Assets

Purchased software and costs directly associated with the internal development of computer software are capitalised as intangible assets where the software is an identifiable asset controlled by the Company which will generate future economic benefits and where costs can be reliably measured. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense as incurred.

Such intangible assets are stated at cost less cumulative amortisation and impairment losses. Amortisation begins when the asset becomes available for operational use and is charged to the income statement on a straight-line basis over the estimated useful life of the software, which is considered to be 10 years. The amortisation periods used are reviewed annually.

Assets are reviewed for impairment at each balance sheet date or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount, if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell, and its value in use.



## **Legal & General Insurance Limited**

### **Notes to the Financial Statements**

#### **1. Accounting Policies (continued)**

##### **m) 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 10 years.

The Company reviews the carrying value of Plant & Equipment at each balance sheet date where there has been an indication that impairment has occurred. If the carrying value of an item of Plant & Equipment is impaired, the carrying value is reduced through a charge to the Statement of Comprehensive Income.

##### **n) 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.

##### **o) 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 2014 or later periods but which the Company has not adopted early, as follows:

IFRS 9, 'Financial Instruments' issued in November 2009 (effective for annual periods commencing on or after 1 January 2018 at the earliest) 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. The Standard retains most of the IAS39 requirements for liabilities, including amortised cost accounting for most financial liabilities, with bifurcation of embedded derivatives. The main change 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 on ordinary activities before tax**

	2013 £'000	2012 £'000
Profit on ordinary activities before tax is stated after charging:		
Depreciation of tangible assets	5	40
Auditors' remuneration (see below for further analysis)	173	317
	<u>178</u>	<u>357</u>

During the year fees (excluding VAT) were paid to the Company auditor for the following services:

**Audit Services**

Audit of these financial statements	107	152
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**Non Audit Services**

Fees payable to the Company auditor for other services:

- Other services pursuant to legislation	66	65
- All other services	-	100
<b>Total</b>	<u>173</u>	<u>317</u>

No gains or losses were recognised on buying reinsurance (2012: £nil).

**3. Investment return**

	2013 £'000	2012 £'000
Investment income	15,771	15,394
Unrealised (losses)/ gains	(9,938)	15,784
Realised (losses)	(657)	(305)
	<u>5,176</u>	<u>30,873</u>

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**

	2013 £'000	2012 £'000
Claims paid		
- gross	155,089	155,978
- reinsurance recoveries	(442)	(700)
	<u>154,647</u>	<u>155,278</u>
Change in insurance liabilities		
- gross	(1,330)	12,083
- reinsurance recoveries	(35)	286
<b>Net claims and change in insurance liabilities</b>	<u>153,282</u>	<u>167,647</u>

**5. Acquisition costs**

	2013 £'000	2012 £'000
Acquisition costs	118,273	110,078
Change in deferred acquisition costs	(5,078)	(3,127)
	<u>113,195</u>	<u>106,951</u>

**Legal & General Insurance Limited**  
**Notes to the Financial Statements**

**6. Finance costs**

	2013	2012
	£'000	£'000
Interest payable to group undertakings	29	24
Preference share dividends	-	29
	<u>29</u>	<u>53</u>

On 22 November 2012, the 3,499,999 preference shares were converted to ordinary shares.

**7. Employee information**

As in 2012, the company has no direct employees since they are employed by a fellow subsidiary of Legal & General Group Plc. As a result the Company incurs no direct staff costs and makes no direct contributions towards retirement benefits (2012: £nil).

**8. Directors' emoluments**

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

	2013	2012
	£'000	£'000
In respect of services as directors:		
Aggregate emoluments	1,584	1,738
Aggregate money purchase contributions	<u>161</u>	<u>138</u>

Defined benefits accrued to 1 (2012: Nil) directors under the Group defined benefit pension scheme.

No fees were paid by the Company to the directors (2012: £nil).

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.

	2013	2012
	£'000	£'000
Highest paid director:		
Emoluments	404	556
Money purchase contributions	<u>-</u>	<u>35</u>

**9. Other expenses**

	2013	2012
	£'000	£'000
Administrative expenses	29,773	22,732
Reinsurance commissions and profit participations	(2,410)	(1,961)
Investment management expenses	<u>500</u>	<u>473</u>
	<u>27,863</u>	<u>21,244</u>

**Legal & General Insurance Limited**  
**Notes to the Financial Statements**

**10. Tax**

	2013 £'000	2012 £'000
<b>Current tax</b>		
- Current tax for the year	8,324	6,344
- Adjustments in respect of prior years	24	61
<b>Total current tax</b>	<u>8,348</u>	<u>6,405</u>
<b>Deferred tax</b>		
- Movement in temporary differences	2,645	2,411
- Impact of reduction in UK corporate tax rate to 20% (2012: 23%)	(1,370)	(685)
<b>Total deferred tax</b>	<u>1,275</u>	<u>1,726</u>
<b>Total tax</b>	<u>9,623</u>	<u>8,131</u>

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

	2013 £'000	2012 £'000
Profit before tax attributable to equity holders	47,180	35,704
Corporation tax at 23.25% (2012: 24.5%)	10,969	8,748
Effects of:		
Adjustments in respect of prior years	24	61
Income not subject to tax, such as dividends	-	7
Impact of reduction in UK corporate tax rate to 20% (2012: 23%) on deferred tax balances	(1,370)	(685)
<b>Tax attributable to equity shareholders</b>	<u>9,623</u>	<u>8,131</u>

**11. Current tax**

	2013 £'000	2012 £'000
Tax due within 12 months	8,348	6,400
<b>Current tax liabilities</b>	<u>8,348</u>	<u>6,400</u>

**Legal & General Insurance Limited**  
**Notes to the Financial Statements**

**12. Deferred tax**

	Net tax assets/(liabilities) as at 1 January 2013	Tax credited/(charged) to the income statement	Net tax assets/(liabilities) as at 31 December 2013
	£'000	£'000	£'000
Excess of depreciation over capital allowances	379	(334)	45
Accounting provision	127	(127)	-
Claims equalisation reserve	(8,950)	(814)	(9,764)
Deferred tax (liabilities)	<u>(8,444)</u>	<u>(1,275)</u>	<u>(9,719)</u>

	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 depreciation over capital allowances	493	(114)	379
Accounting provision	234	(107)	127
Claims equalisation reserve	(7,445)	(1,505)	(8,950)
Deferred tax (liabilities)	<u>(6,718)</u>	<u>(1,726)</u>	<u>(8,444)</u>

**13. Intangible assets**

	2013 £'000
<b>Cost and net book value</b>	
Balance at beginning of year	-
Additions	6,287
<b>Balance at end of year</b>	<u>6,287</u>

Intangible assets relate to the costs directly associated with the development of computer software. No amortisation charge has been recognised in 2013 as the assets are not yet available for operational use.

**14. Plant and equipment**

	2013 £'000	2012 £'000
<b>Cost</b>		
Balance at beginning of year	698	1,343
Additions	501	1
Disposals	(9)	(646)
Balance at end of year	<u>1,190</u>	<u>698</u>
<b>Accumulated depreciation</b>		
Balance at beginning of year	691	1,287
Charge for the year	5	40
Disposals	(9)	(636)
Balance at end of year	<u>687</u>	<u>691</u>
<b>Closing net book value</b>	<u>503</u>	<u>7</u>
<b>Opening net book value</b>	<u>7</u>	<u>56</u>

## Legal & General Insurance Limited

### Notes to the Financial Statements

<b>15. Investments in subsidiaries</b>	2013	2012
	£'000	£'000
As at 1 January	300	2,608
Liquidation of subsidiaries	-	(2,608)
Investment in subsidiary	1,700	300
As at 31 December	<u>2,000</u>	<u>300</u>

The detail of the Company's subsidiaries are set out below:

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

The subsidiaries are 100% owned and have 31 December financial year ends.

On 30th September 2013 the company purchased an additional 1,700 newly issued £1 ordinary shares in Legal & General Distribution Services Limited for a total consideration of £1,700,000.

<b>16. Financial investments</b>	2013	2012
	£'000	£'000
Debt securities and other fixed income securities	342,410	317,412
Accrued interest	6,368	6,684
	<u>348,778</u>	<u>324,096</u>
Expected to be received within 12 months from the reporting date	27,821	16,980
Expected to be received after 12 months from the reporting date	320,957	307,116
	<u>348,778</u>	<u>324,096</u>

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 price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date.

Fair value measurements are based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect 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).

## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 16. Financial Investments (continued)

The following table presents the Company's assets by IFRS 13 hierarchy levels:

	Total	Level 1	Level 2	Level 3
	£'000	£'000	£'000	£'000
As at 31 December 2013				
Debt securities and other fixed income securities	342,410	52,324	290,086	-
Accrued interest	6,368	839	5,529	-
Total financial investments	<u>348,778</u>	<u>53,163</u>	<u>295,615</u>	<u>-</u>
As at 31 December 2012				
Debt securities and other fixed income securities	317,412	45,832	271,580	-
Accrued interest	6,684	1,119	5,565	-
Total financial investments	<u>324,096</u>	<u>46,951</u>	<u>277,145</u>	<u>-</u>

All of the Company's level 2 assets have been valued using standard market pricing sources, such as iBoxx, IDC and Bloomberg, which use mathematical modelling and multiple source validation in order to determine 'consensus' prices. 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 2013 or 2012.

#### 17. Deferred acquisition costs

	Gross 2013 £'000	RI 2013 £'000	Gross 2012 £'000	RI 2012 £'000
As at 1 January	54,986	(1,112)	51,859	(808)
Acquisition costs movement in provision	5,078	(271)	3,127	(304)
As at 31 December	<u>60,064</u>	<u>(1,383)</u>	<u>54,986</u>	<u>(1,112)</u>
To be amortised within 12 months from the reporting date	<u>60,064</u>	<u>(1,383)</u>	<u>54,986</u>	<u>(1,112)</u>

#### 18. Receivables

	2013 £'000	2012 £'000
Receivables arising out of direct insurance operations - policyholders	72,391	65,927
- intermediaries	30,254	31,817
Amounts owed by group undertakings	2,518	30,835
Prepayments and other receivables	5,299	3,962
	<u>110,462</u>	<u>132,541</u>
Receivable within 12 months from the reporting date	<u>110,462</u>	<u>132,541</u>

The Company does not have significant receivables that are past due or considered impaired at 31 December 2013. A total impairment provision of £290,000 was held at the balance sheet date (2012: £47,000).

**Legal & General Insurance Limited**  
**Notes to the Financial Statements**

**19. Cash and cash equivalents**

	2013	2012
	£'000	£'000
Cash at bank and in hand	7,540	7,435
Deposits with credit institutions	25,242	9,190
	<u>32,782</u>	<u>16,625</u>

**20. Insurance contract liabilities**

	Gross 2013 £'000	RI 2013 £'000	Gross 2012 £'000	RI 2012 £'000
Provision for unearned premiums	194,483	(11,079)	178,889	(11,115)
Claims outstanding	102,747	(402)	104,077	(367)
	<u>297,230</u>	<u>(11,481)</u>	<u>282,966</u>	<u>(11,482)</u>

**Expected net insurance claim cash flows**

	Date of undiscounted cash flow					Carrying
	0-1 year	1-2 years	2-3 years	3-4 years	4+ years	value
	£'000	£'000	£'000	£'000	£'000	£'000
<b>As at 31 December 2013</b>						
Claims outstanding	72,861	13,199	5,714	4,060	6,511	102,345
<b>As at 31 December 2012</b>						
Claims outstanding	69,872	11,947	7,413	4,697	9,781	103,710

Insurance cash flows are based on the expected date of settlement.

**Movement in claims liabilities**

	Gross 2013 £'000	RI 2013 £'000	Gross 2012 £'000	RI 2012 £'000
As at 1 January	104,077	(367)	91,994	(653)
Claims arising	174,206	(593)	173,346	(482)
Claims paid	(155,089)	442	(155,084)	700
Adjustments to prior year liabilities	(20,447)	116	(6,179)	68
As at 31 December	<u>102,747</u>	<u>(402)</u>	<u>104,077</u>	<u>(367)</u>

**Unearned premiums**

	Gross 2013 £'000	RI 2013 £'000	Gross 2012 £'000	RI 2012 £'000
As at 1 January	178,889	(11,115)	152,354	(8,161)
Movement in provision	15,594	36	26,535	(2,954)
As at 31 December	<u>194,483</u>	<u>(11,079)</u>	<u>178,889</u>	<u>(11,115)</u>

All unearned premiums are expected to be earned within one year.



## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 21. Claims development tables

The tables below present changes in the historical provision for losses and loss adjustment expenses since 2009 and the provision for losses and loss adjustment expenses arising in each subsequent accident year.

The top section of the tables illustrate 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	2009	2010	2011	2012	2013	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Estimate of ultimate claims costs:						
- At end of accident year	163,609	173,748	123,883	163,875	161,882	786,997
- One year later	156,286	187,426	119,205	149,724		612,641
- Two years later	155,676	184,744	115,842			456,262
- Three years later	155,333	183,168				338,501
- Four years later	154,989					154,989
Estimate of cumulative claims	154,989	183,168	115,842	149,724	161,882	765,605
Cumulative payments	(153,439)	(175,250)	(117,586)	(140,148)	(85,248)	(671,671)
Outstanding claims provision	1,550	7,918	(1,744)	9,576	76,634	93,934
Outstanding claims provision for prior accident years						4,817
Claims handling provision						3,996
Total claims liabilities recognised in the balance sheet						102,747

#### Net of reinsurance

Accident year	2009	2010	2011	2012	2013	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Estimate of ultimate claims costs:						
- At end of accident year	162,364	173,111	123,451	163,523	161,567	784,016
- One year later	155,041	186,868	118,706	149,281		609,896
- Two years later	154,453	184,161	115,366			453,980
- Three years later	154,098	182,591				336,689
- Four years later	153,760					153,760
Estimate of cumulative claims	153,760	182,591	115,366	149,281	161,567	762,565
Cumulative payments	(152,210)	(174,674)	(117,112)	(139,750)	(85,155)	(668,901)
Outstanding claims provision	1,550	7,917	(1,746)	9,531	76,412	93,664
Outstanding claims provision for prior accident years						4,686
Claims handling provision						3,995
Total claims liabilities recognised in the balance sheet						102,345

## Legal & General Insurance Limited

### Notes to the Financial Statements

<b>22. Trade payables</b>	2013	2012
	£'000	£'000
Payables arising from insurance and reinsurance contracts		
- agents, brokers and intermediaries	15,072	17,000
- reinsurers	4,731	11,616
	<u>19,803</u>	<u>28,616</u>

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

<b>23. Other payables</b>	2013	2012
	£'000	£'000
Amounts owed to group undertakings	18,784	44,387
Other payables	19,308	7,887
Reinsurance share of deferred acquisition costs	1,383	1,112
	<u>39,475</u>	<u>53,386</u>

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

#### 24. 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 PRA and FCA, 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 it 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.

#### 25. Share capital

	£'000
<i>Issued and fully paid:</i>	
As at 31 December 2013 & 31 December 2012: 6,999,999 ordinary shares of £1 each	<u>7,000</u>

## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 26. Retained earnings

	2013	2012
	£'000	£'000
Balance at 1 January	57,172	29,599
Retained profit for the year	37,557	27,573
Balance at 31 December	<u>94,729</u>	<u>57,172</u>

#### 27. Holding company

The Company's immediate parent undertaking is Legal & 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 2013. 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](http://www.legalandgeneralgroup.com).

Legal & General Assurance Society Limited is the parent undertaking of the smallest group of undertakings to consolidate these financial statements at 31 December 2013. The consolidated financial statements of Legal & General Assurance Society Limited are available from the Company Secretary at the address above.

#### 28. 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. The following transactions were undertaken, and the corresponding balances payable/ receivable at the year end:

	Charge/ (credit)		Payable/ (receivable)	
	2013	2012	2013	2012
	£'000	£'000	£'000	£'000
a. Investment management portfolio	484	460	42	80
b. Liquidity management	(94)	(64)	(2,507)	(30,835)
c. Group expense charges	53,208	48,055	18,147	16,686
d. Interest relating to preference dividends	-	29	-	-
e. Commission	3,326	3,372	406	120
f. Reinsurance premium	13,116	8,118	189	3,798
g. Settlement of group expenses	-	-	(11)	8

- Legal & General Investment Management (Holdings) Limited ('LGIM') manage the investment portfolio of the Company, and charge the Company a monthly portfolio administration fee.
- Interest charged/(credited) on loan facility by Legal & General Finance Plc at LIBOR plus/ (minus) 0.125% respectively.
- Legal & General Assurance Society Limited recharges the Company for all direct costs associated with the business and an allocated proportion of centralised costs.
- Preference dividend payable to Legal & General Assurance Society Limited (see note 6).
- The Company pays commission for business introduced by Legal & General Partnership Services Limited.
- Reinsurance premium accepted by Legal & General Assurance Society Limited ('LGAS') as part of a wider reinsurance treaty. In addition, as at 31 December 2012 a further £27,493,000 was payable to LGAS in respect of cash received on behalf of and due to be paid over to LGAS.
- The Company settles group recharges on behalf of Legal & General Distribution Services Limited, who subsequently reimburse the Company.

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

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

## **Legal & General Insurance Limited**

### **Notes to the Financial Statements**

#### **29. 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 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.

##### **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.

## Legal & General Insurance Limited Notes to the Financial Statements

### 29. Critical accounting estimates and judgements (continued)

#### Exposure based methods (continued)

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:

- On Household, our biggest driver of uncertainty, 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.
- A 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.

Given this uncertainty, it is Company policy to hold reserves above the best estimate. Current policy is to hold reserves between the mean and 75th percentile of the overall distribution (2012: between 60th and 65th percentiles), depending on the perceived risk in the reserves. The precise choice of percentile is based on seven criteria, which are given a low, medium or high rating. The overall score determines the percentile booked.

The margin held as at 31 December 2013 was 8% (2012: 4.7%) of the gross booked reserves (excluding claims handling expenses). 4% of this margin was held specifically for adverse development of the December 2013 weather. The remainder was held for other uncertainties.

Reserving at this level provides a margin against reasonable levels of uncertainty, whilst avoiding excessive prudence for IFRS reporting purposes.

#### Financial impact of the uncertainty

All figures in this section are based on the reserving exercise performed as at 31 December 2013.

#### Household

The household margin is 8% of the booked reserves (2012: 3% plus £1,500,000). This could be used to cover adverse liability experience, as well as adverse development of the December weather or other claims.

The table below shows how much extra the Company would need to hold in pounds if the IBNR were to increase by differing percentages. The table shows that the £3.5m attritional margin would have been enough to cover a 17% increase in IBNR excluding weather.

Increase in best estimate IBNR excluding weather	Extra reserve required (£)
5%	1,007,169
10%	2,014,339
15%	3,021,508
20%	4,028,677
25%	5,035,847

#### Accident, Sickness and Unemployment

If non reinsurance backed IBNR claims increased by 50% the Company would need to hold an extra 8% (2012: 12%) of the best estimate reserve for this class of business (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% (2012: 11%) of the best estimate reserve for this class of business.

If these two events occurred at the same time the Company would need to hold an extra 19% (2012: 23%) of the best estimate reserve for this class of business. However, the probability of this occurrence would be very small.

## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 30. 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; and
- 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 recoverable 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.

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 £43m and £456m (2012: £36m and £360m) 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 (2012: £0.75m). A further reinsurance treaty protects against individual large losses on the company's social housing portfolio, for claims between £1m and £9m (2012: £1m and £8m) and terrorism cover is in place to cover terror related claims in excess of £0.1m (2012: £0.1m).

**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.

## Legal & General Insurance Limited

### Notes to the Financial Statements

#### 30. Risk management and control (continued)

##### Insurance risk (continued)

**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.

During the year a motor product was launched by the Company's subsidiary, Legal & General Distribution Services Limited. This product is currently administered by a third party and underwritten by a panel of insurers who bear the associated insurance risk.

**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 upto 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 accident, sickness and unemployment claims' 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 interest rates. 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 to policyholders.

The sensitivity analysis considers the impact on the value of the Company's 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.

## Legal & General Insurance Limited Notes to the Financial Statements

### 30. Risk management and control (continued)

#### Credit risk

The Company's exposure to credit risk includes:

- Banking counterparty risk;
- Investment counterparty risk;
- Reinsurer credit risk; and
- 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 (2012: £nil) 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
<b>As at 31 December 2013</b>							
Government securities	-	13,712	-	-	-	-	13,712
Other fixed rate securities	81,802	36,114	101,628	104,306	3,068	-	326,918
Variable rate securities	-	-	1,780	-	-	-	1,780
<b>Total debt securities</b>	<b>81,802</b>	<b>49,826</b>	<b>103,408</b>	<b>104,306</b>	<b>3,068</b>	<b>-</b>	<b>342,410</b>
Accrued interest	1,602	707	1,836	2,180	43	-	6,368
Cash and cash equivalents	-	-	32,782	-	-	-	32,782
<b>Financial assets</b>	<b>83,404</b>	<b>50,533</b>	<b>138,026</b>	<b>106,486</b>	<b>3,111</b>	<b>-</b>	<b>381,560</b>
Reinsurers' share of contract liabilities	-	7,059	4,289	133	-	-	11,481
Other assets	-	-	2,507	-	-	176,809	179,316
<b>Total</b>	<b>83,404</b>	<b>57,592</b>	<b>144,822</b>	<b>106,619</b>	<b>3,111</b>	<b>176,809</b>	<b>572,357</b>

	AAA £'000	AA £'000	A £'000	BBB £'000	BB & below £'000	Unrated £'000	Total £'000
<b>As at 31 December 2012</b>							
Government securities	13,934	-	-	-	-	-	13,934
Other fixed rate securities	80,633	21,795	102,860	95,682	-	-	300,970
Variable rate securities	-	2,508	-	-	-	-	2,508
<b>Total debt securities</b>	<b>94,567</b>	<b>24,303</b>	<b>102,860</b>	<b>95,682</b>	<b>-</b>	<b>-</b>	<b>317,412</b>
Accrued interest	2,172	325	2,166	2,021	-	-	6,684
Cash and cash equivalents	-	9,190	7,435	-	-	-	16,625
<b>Financial assets</b>	<b>96,739</b>	<b>33,818</b>	<b>112,461</b>	<b>97,703</b>	<b>-</b>	<b>-</b>	<b>340,721</b>
Reinsurers' share of contract liabilities	53	5,746	5,323	360	-	-	11,482
Other assets	-	-	30,835	-	-	156,999	187,834
<b>Total</b>	<b>96,792</b>	<b>39,564</b>	<b>148,619</b>	<b>98,063</b>	<b>-</b>	<b>156,999</b>	<b>540,037</b>



**Legal & General Insurance Limited**  
**Notes to the Financial Statements**

**30. Risk management and control (continued)**

**Liquidity risk**

Liquidity risk is the risk that the Company 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.

The Company 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.

The Company has entered into a ten-year arrangement with Legal & General 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 Company's financial and insurance Risk Committee, which seeks to avoid a large balance piling up.

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.

**Legal & General Insurance Limited**  
**Notes to the Financial Statements**

**30. 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	Impact on equity net of reinsurance	Impact on pre-tax profit net of reinsurance	Impact on equity net of reinsurance
	2013 £'000	2013 £'000	2012 £'000	2012 £'000
<b>Sensitivity test</b>				
Single storm event with 1 in 200 year probability	(73,194)	(56,176)	(62,850)	(47,452)
Subsidence event - worst claim ratio in last 30 years	(55,215)	(42,377)	(49,641)	(37,479)
Economic downturn	(46,978)	(36,056)	(41,429)	(31,279)
5% decrease in overall claims ratio	7,069	5,426	7,823	5,906
5% surplus over claims liabilities	5,117	3,927	5,201	3,926

For any single event with claims in excess of £43m (2012: £36m) but less than £456m (2012: £360m) the ultimate cost to the Company would be £43m (2012: £36m) plus the cost of the reinsurance reinstatement premia. The impact of a 1 in 500 year modelled windstorm and coastal flood event would exceed the catastrophe cover by approximately £210m (2012: £180m), with an estimated total cost to the Company of £287m (2012: £246m).

**Capital sensitivity analysis**

The table below provides management estimates of the impact on the Company's capital surplus (measured on an IGD basis) to changes in market conditions:

	Impact of surplus capital	
	2013 £'000	2012 £'000
<b>Sensitivity test</b>		
100bps increase in interest rates	(11,214)	(10,000)
100bps decrease in interest rates	11,214	10,000
100bps increase in credit spreads	(10,783)	(9,500)

**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 Individual Capital Assessment ('ICA') capital are made to the PRA every 2 years, with capital calculations for internal use being completed quarterly. The most recent ICA submission made to the Financial Services Authority (the predecessor to the PRA and FCA) as at 31 December 2012.

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