Ageas Insurance Limited

Directors' Report & Financial Statements

for the year ended 31 December 2012

Personal Lines | Commercial Lines | Protection

Ageas Insurance Limited

Directors' Report and Financial Statements
For the year ended 31 December 2012

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Ageas Insurance Limited

Directors and Advisers

Directors

Adam J Clarke	
Barry D Smith	
Christopher Dobson	
Helen A Pickford	
Jeffrey O Grosvenor	
Julian C Hance	
Lyn G Nicholls	
Mark Cliff	
Michael N Urmston	
Robert J Smale	
Mark Winlow	Appointed 05/10/2012
Andrew S Watson	Appointed 08/02/2013
Francois-Xavier B Boisseau	Appointed 08/02/2013

Secretary

Rosemary A Smith

Head Office and Registered Address

Ageas Insurance Limited
Ageas House
Tollgate
Eastleigh
SO53 3YA

Registered Number

354568
Registered in England

Independent Auditor

KPMG Audit Plc
15 Canada Square
London
E14 5GL

Bankers

HSBC
165 High Street
Southampton
SO14 2NZ

Ageas Insurance Limited

Report of the Directors

The directors submit their report, together with the audited financial statements for the year ended 31 December 2012.

Activities

During the year, Ageas Insurance Limited ('the Company') continued to develop its personal lines business (motor, household, travel and special risks) and its commercial lines business (vehicle, property, liability and small motor fleet).

The Company also administered the run-off of its Marine and City business for which it ceased accepting new business in 1991.

Ageas Services (UK) Limited, a 100% owned subsidiary of Ageas Insurance Limited, was sold on 1 October 2012 for £434,583. It was sold to Ageas (UK) Limited, the Company's immediate parent.

Results

The results of the Company are contained in the accounts on pages 7 to 44. The profit before taxation during 2012 was £64.7m (2011: profit £66.6m). Additional explanation is included in the business review later in this report.

Strategic Direction

The vision for the Company is to profitably grow Ageas' presence in the UK general insurance market through:

- the delivery of a wide range of insurance solutions focusing on Personal Lines and Commercial Lines small businesses;
- aligning itself with the Ageas UK strategy; adjusting to changing market trends, with a focus on increased penetration of the broker and intermediary channel and the affinity partnership market; and
- leveraging the combined capability of the Ageas UK business.

The realisation of this strategy will see Ageas reinforce its presence as one of the established general insurers in the UK. To achieve this vision, the Company will:

- continue to strengthen and develop its manufacturing capabilities, widening the product range to reach more consumers and target market segments;
- continue to broaden penetration of the market through wider and deeper distribution relationships focused on the intermediated channel, together with the development of direct to consumer manufacturing techniques in support of Ageas' UK multi channel strategy; and
- focus on aligning internal and external business processes to the needs of customers (consumers, clients and partners), following the Company's "service up, cost down" ethos by driving out failure demand.

The strategy will be underpinned by the following aspirations, some of which will require investment and enhancement over the plan period:

- to provide insurance solutions for our clients as an assembler, provider of capital and claims manager;
- to meet the needs of our clients and their customers;
- to find solutions that are flexible and provide profitable growth potential: we will seek to be a low cost provider across all products;
- to ensure products have standalone profitability and risks are underwritten for profit;
- to continue to distribute across multiple distribution channels, responding to emerging channels as they develop;
- to deliver sustained profitable growth for the Company's shareholders over the plan period;
- to broaden access to decision makers to ensure continued quick response to clients and opportunities as the Company grows; and
- to continue to maintain the manufacturing IT systems on a single platform.

Ageas Insurance Limited

Report of the Directors (continued)

Business Review

The Board considers that the key indicators that will communicate the financial performance and strength of the Company to its members are:

- Gross written premiums
- Profit before taxation
- Operating ratios
- Return on capital

The Board also uses a number of other key indicators to assess the performance of individual parts of the business, including details on the number of policies written and various performance ratios.

	2012 £m	2011 £m	Change %
Gross written premiums	1,097.1	1,066.1	2.9

The written premium drives the size of the business and underwriting at the appropriate rates for the risks undertaken drives profitability. Action is taken continuously to ensure that business is written at rates required to achieve the target return on capital.

	2012 £m	2011 £m	Change %
Profit before taxation	64.7	66.6	(2.9)
Profit before taxation and non-recurring administrative expenses	74.8	66.6	12.3

The profit before taxation is the key performance measure. The Company aims to deliver sustainable growth in profits over the insurance cycle by risk selection at appropriate rates, rigorous expense control and the delivery of superior customer service to its policyholders and intermediaries.

	2012 %	2011 %	Change %
Profit ratio	93.6	92.9	(0.6)
Profit ratio before non-recurring administrative expenses	92.6	92.9	0.3

The profit ratio is considered as a measure of the Company's overall efficiency. It is calculated as the total of incurred claims, commissions, expenses and reinsurance, less investment income, as a percentage of net earned premiums. Operating ratios may be affected by external factors in addition to the actions of management that may not necessarily be reflected immediately as they require time to impact the result.

	2012 %	2011 %	Change %
Return on capital after tax	13.1	13.6	(0.5)
Return on capital after tax and before non-recurring administrative expenses	15.6	13.6	2.0

Return on capital is a measure of the efficiency with which the Company uses its shareholders' equity. This is measured by taking the profit after tax over average shareholders' equity adjusted for any dividends that have been paid.

The Company reported record premium income of £1,097.1m (an increase of 2.9% over 2011) with strong profitable growth in Motor lines, partially offset by a reduction in business written in both Household and Travel lines due to a strategy of pricing for profitability.

The Company reported Profit before taxation and non-recurring administrative expenses of £74.8m in 2012 and a net profit ratio of 92.6%, an improvement of 0.3% over 2011. Profit before taxation and after non-recurring expenses was £64.7m with a net profit ratio of 93.6%. Weather events during the year amounted to £48.4m million across Household, Commercial and Motor combined. A strong Motor performance delivered a net profit ratio of 89.1% and a combined ratio of 95.1%, an improvement from 2011 of 1.9% and 1.6% respectively, contributing heavily to the improved profit before tax excluding non-recurring expenses.

The Company paid a dividend of £88.0m to Ageas (UK) Limited during 2012, partially offset by the issue of perpetual subordinated debt to the same parent company (£40.0m).

The Company has retained its strong capital position with 2.1 times the FSA's minimum capital requirements.

Report of the Directors (continued)

Business Review (continued)

On the 14th November 2012 the entire share capital of Groupama Insurance Company Limited ('Groupama') was acquired by Ageas (UK) Limited, the immediate parent company of the Company.

Ageas UK has decided that the optimal approach for its broker focused insurance undertakings is to undertake a transfer of Groupama's business to Ageas Insurance Limited under part VII of the FSMA (2000). This process requires regulatory approval and a court order from the Royal Courts of Justice.

As part of its continued investment in the local economy the Company completed the purchase for new office space, in the Hampshire Corporate Park on Templars Way in Eastleigh, in May 2012. The new offices will give the Company scope for further growth with the office move expected to take place during 2013.

Shareholders' equity

Retained earnings within shareholders' equity decreased by £40.7m (2011: increase £48.8m). There was an increase in the market value of investments net of tax compared to their carrying value that increased the fair value reserve by £7.3m (2011: increase £18.5m). In total, shareholders' equity decreased by £33.4m (2011: increase £67.3m). A dividend of £88.0m was paid in the year, which exceeded the profit for the year of £47.3m. The subordinated debt is held as a financial liability.

Assets

Total assets increased by £72.3m in the year (2011: £177.9m) with financial assets decreasing by £33.5m (2011: increase of £122.5m). Cash increased by £119.1m (2011: increase £8.2m). All financial investments were held in fixed rate debt securities (2011: 100%).

Liabilities

Total liabilities increased by £105.7m in the year (2011: £110.6m) with insurance contract provisions increasing by £78.5m (2011: £103.6m). The increase is mainly due to the growth in the Company's written premiums, and the issue of £40.0m of subordinated debt during the year.

Cash flow

Inclusive of investment in financial assets, cash resources available to the Company increased by £85.6m (2011: increase £114.3m) in the year. All financial assets are liquid and can be converted to cash in a normal market at short notice.

Principal risks and uncertainties

The Company's principal risks and uncertainties and the way in which these risks are managed are detailed in note 2 to the financial statements. The fundamental risks to which the Company is exposed have not changed during the year.

Results and dividends

The result of the year's operation is a profit after taxation of £47.3m (2011: profit £48.8m). A dividend of £0.2m was received from the Company's subsidiary, Ageas Services (UK) Limited prior to its disposal (2011: £nil). No dividend was received from the Company's subsidiary, Bishopsgate Head Office Limited (2011: £nil). A dividend of £88.0m (2011: £nil) was paid to the Company's parent, Ageas (UK) Limited during the year.

Disclosure of information to Auditors

The Members of the Board are shown on page 2. All directors served throughout the year and to the date of this report with the exception of those highlighted on page 2. The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Ageas Insurance Limited

Report of the Directors (continued)

Auditors

Pursuant to Section 487 of the Companies Act 2006, the auditors will be deemed to be reappointed and KPMG Audit Plc will therefore continue in office.

Creditor payment policy

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

Employees

The average number of persons employed in the United Kingdom by the Company and its subsidiaries during the year was 1,939. The full time equivalent number of employees adjusted for part time staff was 1,785. Their annual aggregate remuneration was £60.1m. An analysis is shown in note 28.

Employee involvement

Employees are kept up to date about a wide range of Company developments through a programme of engagement activities, delivered through a variety of channels. This includes formal Director briefings for all employees and communication by management on the Company's performance and strategy, as well as regular bulletins and employee newsletters. In addition, informal discussions take place between senior management and the formal employee consultation bodies. In 2012 Ageas ran its fourth UK-wide engagement survey and launched an intranet to further promote a two-way dialogue between employees and the organisation, and to connect people across different businesses.

Disabled persons

In line with the Equality Act 2010 we have taken a number of actions in response. The Act consolidates the range of discrimination legislation that has previously been in place and, as a result, the Company's policy and procedures have been reviewed. The requirements have been built into our management training and an e-learning module has been created to further embed our approach to a diverse working environment. Our approach to diversity is monitored regularly.

Charitable donations

Charitable donations in the year amounted to £970 (2011: £nil). All significant charitable donations for this year have been made by the parent company, Ageas (UK) Limited.

This report was approved by the Board of Directors on 27 March 2013 and signed on its behalf by:

R A Smith
Secretary

Ageas Insurance Limited

Company registration number: 354568

Statement of comprehensive income

For the year ended 31 December 2012

	Note	2012 £m	2011 £m
Gross written premiums	3	1,097.1	1,066.1
Change in the gross provision for unearned premiums	3	(13.1)	(60.7)
Gross insurance premium revenue		1,084.0	1,005.4
Written premiums ceded to reinsurers	3	(80.2)	(63.1)
Reinsurers' share of change in the provision for unearned premiums	3	5.5	1.0
Net insurance premium revenue		1,009.3	943.3
Commission income	4	4.7	3.9
Investment income	5	49.0	47.5
Other operating income	6	22.9	20.8
Net income		1,085.9	1,015.5
Claims and benefits incurred	7	(756.1)	(740.8)
Reinsurers' share of claims and benefits incurred		27.5	42.2
Net policyholder claims and benefits incurred		(728.6)	(698.6)
Acquisition costs	8	(256.1)	(236.3)
Administration costs	9	(24.0)	(14.0)
Operating profit before non-recurring administrative expenses and finance costs		77.2	66.6
Finance costs	10	(2.5)	-
Non-recurring administrative expenses	12	(10.0)	-
Profit/(loss) before income taxes		64.7	66.6
Income tax (charge)/credit	11	(17.4)	(17.8)
Profit/(loss) for the year		47.3	48.8
Other comprehensive income			
Gross change in fair value of financial assets available-for-sale	16	10.7	24.0
Income tax on other comprehensive income	11	(3.4)	(5.5)
Other comprehensive income, net of tax		7.3	18.5
Total comprehensive income		54.6	67.3

The notes on pages 20 to 44 form an integral part of these financial statements.

Ageas Insurance Limited

Company registration number: 354568

Statement of financial position

As at 31 December 2012

	Note	2012 £m	2011 £m
Assets			
Employee benefits	24	13.2	10.7
Investments in subsidiaries	15	0.0	0.4
Property, plant and equipment	13	18.6	7.0
Deferred acquisition costs	14	126.6	121.3
Financial assets	16	1,292.4	1,325.9
Reinsurance assets	17	128.4	123.8
Insurance and other receivables	19	221.6	258.5
Cash and cash equivalents	20	186.0	66.9
Total assets		1,986.8	1,914.5
Shareholders' equity			
Share capital		71.1	71.1
Share premium		3.9	3.9
Retained earnings		223.8	264.5
Other reserves		61.6	54.3
Total shareholders' equity		360.4	393.8
Liabilities			
Insurance contract provisions	17	1,492.2	1,413.7
Financial liabilities:			
- Loans and borrowings from group companies	21	40.0	8.9
- Other (Funds held under reinsurance agreements)		0.3	-
Reinsurance payables		5.2	12.3
Insurance payables, other payables and deferred income	22	68.7	62.0
Other provisions	23	7.5	0.6
Current tax liability	25	7.4	20.3
Deferred tax liabilities	18	5.1	2.9
Total liabilities		1,626.4	1,520.7
Total equity and liabilities		1,986.8	1,914.5

The notes on pages 20 to 44 form an integral part of these financial statements.

These financial statements were approved by the board of directors on 27 March 2013 and were signed on its behalf by:

M Cliff
Director

H A Pickford
Director

Ageas Insurance Limited

Company registration number: 354568

Statement of changes in equity

As at 31 December 2012

	Share capital £m	Share premium £m	Retained earnings £m	Other reserves Fair value reserve* £m	Other reserves Statutory reserve £m	Total £m
Balance at 1 January 2011	71.1	3.9	215.7	21.8	14.0	326.5
Profit/(loss) for the year	-	-	48.8	-	-	48.8
Fair value gains/(losses)	-	-	-	18.5	-	18.5
Dividends to shareholders	-	-	-	-	-	-
Balance at 31 December 2011	71.1	3.9	264.5	40.3	14.0	393.8
Balance at 1 January 2012	71.1	3.9	264.5	40.3	14.0	393.8
Profit/(loss) for the year	-	-	47.3	-	-	47.3
Fair value gains/(losses)	-	-	-	7.3	-	7.3
Dividends to shareholders	-	-	(88.0)	-	-	(88.0)
Balance at 31 December 2012	71.1	3.9	223.8	47.6	14.0	360.4

*The fair value reserve includes the cumulative net change in the fair value of available-for-sale investments, net of tax, until the investment is derecognised.

The notes on pages 20 to 44 form an integral part of these financial statements.

Ageas Insurance Limited

Company registration number: 354568

Statement of cash flows

For the year ended 31 December 2012

	Note	2012 £m	2011 £m
Cash flows from operating activities			
Profit/(loss) before tax		64.7	66.6
Adjustments for:			
Dividend income	5	(0.2)	(0.0)
Interest income	5	(39.6)	(41.5)
Finance costs	10	2.5	0.0
Depreciation of buildings, plant and equipment	13	3.0	2.6
Change in deferred acquisition costs	14	(5.3)	(13.4)
Financial assets non cash movements	16	(14.4)	(12.9)
Operating profit/ (loss) before working capital changes		10.7	1.4
Decrease/(increase) in financial assets	16	58.6	(85.6)
Decrease/(increase) in reinsurance assets		(4.6)	(8.8)
Decrease/(increase) in insurance and other receivables		36.9	(41.4)
Increase/(decrease) in insurance contract provisions, other payables and deferred income		85.2	99.0
Increase/(decrease) in reinsurance payables		(7.1)	(1.6)
Increase/(decrease) in financial liabilities		(8.6)	(0.6)
Decrease/(increase) in other liabilities and provisions		4.4	(6.9)
Cash flows used in operations		175.5	(44.5)
Interest received	5	39.6	41.5
Interest paid	10	(2.5)	(0.0)
Income taxes paid		(31.5)	(1.5)
Net cash flows from operating		181.1	(4.5)
Cash flows from investing activities			
Dividend income	5	0.2	0.0
Disposal of subsidiary	15	0.4	-
Purchase of property, plant and equipment	13	(14.6)	(3.7)
Net cash used in investing activities		(14.0)	(3.7)
Cash flows from financing activities			
Dividends Paid		(88.0)	-
Subordinated Debt		40.0	-
Net cash used in financing activities		(48.0)	-
Net increase/(decrease) in cash and cash equivalents		119.1	(8.2)
Cash and cash equivalents at 1 January		66.9	75.1
Cash and cash equivalents at 31 December		186.0	66.9
Cash available to the Company		185.4	66.3
Cash not available to the Company - held in trust		0.6	0.6
	20	186.0	66.9

The notes on pages 20 to 44 form an integral part of these financial statements.

Ageas Insurance Limited

Significant accounting policies

Ageas Insurance Limited is a private company, limited by shares, domiciled and incorporated in England and Wales. The Company is primarily involved in personal and commercial lines insurance.

(a) Statement of compliance

The financial statements were approved for issue by the Board of Directors on 27 March 2013.

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU).

The financial statements have also been prepared in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The Company has not applied IFRS 8 Operating Segments. In accordance with IFRS 8, the Company is not required to present segmental information as the equity of the Company is not publicly traded.

(b) Basis of preparation

The Company has elected not to prepare consolidated financial statements. The accounts as prepared are separate financial statements and the exemption from consolidation, in accordance with the CA 2006 s400(2), has been used.

The Company has prepared the financial statements on a going concern basis.

The Company presents its statement of financial position in order of liquidity in accordance with IAS 1 Presentation of Financial Statements. For each asset and liability line item in the statement of financial position that details amounts expected to be recovered or settled within twelve months, or more than twelve months after the statement of financial position date, a classification at the statement of financial position date is included within the notes. The disclosures in the notes for these classifications are distinguished as follows:

- amounts expected to be recovered in less than one year are referred to as current; and
- amounts expected to be recovered in more than one year are referred to as non-current.

All new standards and interpretations released by the International Accounting Standards Board (IASB) have been considered and of these the following new and amended standards have been adopted by the group during the period:

IAS 12 Amendment: Deferred tax: Recovery of underlying assets (effective 1 January 2012). The amendment provides a practical solution to the application of these requirements in relation to investment property under IAS 40, introducing a presumption that recovery of the carrying amount of an investment property will normally be through sale.

IAS 1 (amended), 'Presentation of financial statements'. IAS 1 is amended to clarify that reconciliation from opening to closing balances is required to be presented in the statement of changes in equity for each component of equity. IAS 1 is also amended to allow the analysis of the individual other comprehensive income line items by component of equity to be presented in the notes.

In addition, the following is a list of standards that are in issue but are not effective in 2012, and have not yet been adopted in the EU, together with the effective date of application to the group:

- IFRS 9: Financial Instruments (effective 1 January 2015)
- IFRS 10: Consolidated financial statements (effective 1 January 2013)
- IFRS 11: Joint arrangements (effective 1 January 2013)
- IFRS 12: Disclosure of interests in other entities (effective 1 January 2013)
- IFRS 13: Fair Value Measurement (effective 1 January 2013)
- IAS 19 Amendment: Defined benefit plans (effective 1 January 2013)
- IAS 32 Amendment: Offsetting financial assets and financial liabilities (effective 1 January 2014)
- IFRS 7: Amendment: Offsetting financial assets and liabilities (effective 1 January 2013)
- IAS 27: Separate financial statements (effective 1 January 2013)
- IAS 28: Investments in associates and joint ventures (effective 1 January 2013)

The implications of these standards and interpretations are under review.

Significant accounting policies

(i) Basis of measurement

The financial statements have been prepared on the historical cost basis except that financial instruments classified as available-for-sale are stated at their fair value.

(ii) Functional and presentation currency

The financial statements are presented in millions of Pounds Sterling, which is the Company's functional currency. All financial information presented in Pounds Sterling has been rounded to one decimal place.

(iii) Use of estimates and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. These form the basis of judgements concerning carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised if the revision affects only that year, or in the year of the revision and future years if the revision affects both current and future years.

Judgements made by the directors in the application of IFRS that have a significant effect on the financial statements, and estimates with a significant risk of material adjustment in the next year, are discussed in notes 1 and 2.

The accounting policies set out below have been applied consistently to all years presented in these financial statements.

(c) Classification of insurance contracts

Contracts under which the Company accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the other party are classified as insurance contracts. These contracts remain insurance contracts until all rights and obligations are extinguished or expire. Insurance contracts may also transfer some financial risk.

(d) Recognition and measurement of revenue

Premiums

Gross written premiums comprise the premiums on contracts entered into during the year, irrespective of whether they relate in whole or in part to a later accounting period. Premiums are mainly disclosed gross of commission payable to intermediaries and exclude taxes. Written premiums include adjustments to premiums written in prior accounting periods and estimates for “pipeline” premiums. An estimate is made at the statement of financial position date to recognise retrospective adjustments to premiums or commissions. The earned portion of premiums received, is recognised as revenue. Pipeline premiums are brought into account, based upon the pattern of booking of renewals and new business. Premiums are earned from the date of attachment of risk, over the indemnity period, based on the pattern of risks underwritten. Outward reinsurance premiums are recognised as a deduction from net insurance revenue in accordance with the contractual arrangements with reinsurers.

Unearned premiums provision

The provision for unearned premiums comprises the proportion of gross written premiums which is estimated to be earned in the following or subsequent financial years, computed separately for each insurance contract using the daily pro rata method, adjusted if necessary to reflect any variation in the incidence of risk during the period covered by the contract. For schemes this is calculated using the monthly pro rata method.

(d) Recognition and measurement of revenue (continued)

Claims

Claims incurred consist of claims and claims handling expenses paid during the financial year, together with the movement in the provision for outstanding claims.

Claims outstanding comprise provisions for the Company's estimate of the ultimate cost of settling all claims incurred but unpaid at the statement of financial position date whether reported or not, and related internal and external claims handling expenses. Claims outstanding are assessed by reviewing individual claims and making allowance for claims incurred but not yet reported, adjusted for the effect of both internal and external foreseeable events, such as changes in claims handling procedures, inflation, judicial trends, legislative changes and past experience and trends. Anticipated reinsurance recoveries and estimates of salvage and subrogation recoveries are presented separately as assets. Reinsurance and other recoveries are assessed in a manner similar to the assessment of claims outstanding.

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

Liability adequacy test (Unexpired risk provision)

Provision is made for unexpired risks arising from business where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the statement of financial position date exceeds the unearned premiums provision in relation to such policies after the deduction of any deferred acquisition costs. The provision for unexpired risks is calculated separately by reference to classes of business which are managed together, after taking into account the relevant investment return.

Reinsurance

The Company cedes reinsurance in the normal course of business for the purpose of limiting its net loss potential through the diversification of its risks. Reinsurance arrangements do not relieve the Company from its direct obligations to its policyholders.

Premiums ceded and benefits reimbursed are presented in the statement of comprehensive income and statement of financial position on a gross basis.

Only contracts that give rise to a significant transfer of insurance risk are accounted for as reinsurance contracts. Amounts recoverable under such contracts are recognised in the same year as the related claim. Contracts that do not transfer significant insurance risk (i.e. financial reinsurance), are accounted for as financial instruments.

Reinsurance assets include balances due from reinsurance companies for reinsurance claims. Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsured policy.

Amounts recoverable under reinsurance contracts are assessed for impairment at each statement of financial position date. Such assets are deemed impaired if there is objective evidence, as a result of an event that occurred after its initial recognition, that the Company may not recover all amounts due and that the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer.

Deferred acquisition costs

Commission payable to agents and internally generated acquisition costs, which are incurred for acquiring new and renewal insurance business that is primarily related to the production of that business, are deferred.

Such deferred acquisition costs are finite and are amortised by reference to the basis on which the related premiums are earned which is generally one year or less.

Other assessments and levies

The Company is obligated to pay various guarantee fund levies or other insurance industry related assessments. Those incurred in relation to the writing of premiums are expensed in line with the earning of premiums.

Significant accounting policies

(e) Commission income

Commissions received or receivable which do not require the Company to render further service are recognised as revenue by the Company. Reinsurance commissions are deferred and amortised on a pro rata basis over the contract term.

(f) Investment income

Investment income comprises interest income, dividend income and net realised gains from available-for-sale financial assets earned in the period. Interest income is recognised as it accrues in the income statement, using the effective interest method. Dividend income is recognised in the income statement on the date that the Company's right to receive payment is established.

(g) Expenses

(i) Operating lease payments

Payments made under operating leases are recognised in the statement of comprehensive income on a straight line basis over the term of the lease.

(ii) Finance costs

Finance costs comprise interest payable on borrowings calculated using the effective interest rate method and are expensed in the statement of comprehensive income in the period to which they relate.

(h) Employee benefits

(i) Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which a company pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an employee benefit expense in the statement of comprehensive income when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

(ii) Defined benefit plans

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Company's net obligation in respect of defined benefit pension plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior years; that benefit is discounted to determine its present value, and the fair value of any plan assets is deducted. The discount rate is the yield at the statement of financial position date on AA credit rated bonds that have maturity dates approximating to the terms of the Company's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised as an expense in the income statement on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in the income statement.

All actuarial gains and losses as at 1 January 2005, the date of transition to IFRS, were recognised in the statement of financial position as at that date. In respect of actuarial gains and losses that arise subsequent to 1 January 2005 in calculating the Company's obligation in respect of a plan, to the extent that any cumulative unrecognised actuarial gain or loss exceeds 10 per cent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in the statement of comprehensive income over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

Where the calculation results in a benefit to the Company, the recognised asset is limited to the net total of any unrecognised actuarial losses, past service costs and the present value of any future refunds from the plan or reductions in future contributions to the plan.

Significant accounting policies

(i) Income tax

Income tax expense in the statement of comprehensive income for the year comprises current and deferred tax. Income tax is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in equity, in which case the related income tax is also recognised in equity.

Current tax is the expected tax payable on the taxable profit for the year, using tax rates enacted or substantively enacted at the statement of financial position date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided in full, using the statement of financial position liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes, and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the statement of financial position date.

The Finance Act 2012 enacted corporation tax rates of 24% from 1 April 2012 and 23% from 1 April 2013. On 11 December 2012 it was announced that the rate from 1 April 2014 will be 21%, and on 20 March 2013 it was announced that the rate from 1 April 2015 will be 20%. These rate changes are not enacted. The 23% rate has been enacted and has been taken into consideration in the deferred tax calculation.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax assets and liabilities are not discounted.

(j) Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency of the Company at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the statement of financial position date are translated to the presentational currency (pounds sterling) at the foreign exchange rate ruling at that date.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to pounds sterling at foreign exchange rates ruling at the dates the fair value was determined.

Foreign exchange differences arising on translation are recognised in the income statement.

Significant accounting policies

(k) Property, plant and equipment

(i) Owned assets

Items of property, plant and equipment are stated at cost (or deemed cost) less accumulated depreciation (see below) and impairment losses (see accounting policy (p)). Cost includes expenditure that is directly attributable to the acquisition of the asset. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment. Borrowing costs related to the acquisition of qualifying assets are recognised as part of the cost of those assets in the statement of financial position.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

(ii) Leased assets

Leases under the terms of which the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Other leases are classified as operating leases and are not recognised in the Company's statement of financial position.

(iii) Depreciation

Depreciation is charged to the statement of comprehensive income on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term. Land is not depreciated.

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

The estimated useful lives are as follows:

Buildings	Fifty years
Leasehold buildings and improvements	Period of the lease
Equipment and motor vehicles	Two to five years
IT equipment	Three to five years

The gain or loss arising on the disposal of an asset is determined as the difference between the sale proceeds and the carrying value of the asset and is recognised in the statement of comprehensive income.

(l) Investment in subsidiaries

Investments in group undertakings are stated at the lower of cost or net realisable value. Details of transactions with group companies are included in note 29, Related Party Transactions.

(m) Financial investments

Financial investments are held as available-for-sale. There are no derivatives.

Financial investments are recognised initially at fair value without any deduction for transaction costs the Company may incur on disposal. Purchases of financial investments are recognised on the trade date, which is when the Company commits to purchase the instrument.

The fair value of quoted investments is their quoted bid prices at the statement of financial position date.

Realised gains and losses are included in the statement of comprehensive income in the period in which they arise. Unrealised gains and losses arising from changes in the fair value of financial investments are recognised directly in equity, except for foreign exchange gains and losses on monetary items such as debt securities, which are recognised in the statement of comprehensive income. When financial investments are sold or impaired, the cumulative gains or losses previously recognised in equity are recognised in the statement of comprehensive income. Where these investments are interest-bearing, interest is calculated using the effective interest method and is recognised in the statement of comprehensive income.

Financial assets with fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. The Company classifies cash and short term deposits and insurance and other receivables, including amounts due from related companies, as loans and receivables. The directors have determined that their carrying amounts reasonably approximate their fair values as they are mostly short term in nature or are repriced frequently.

Loans and receivables are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest method, less any impairment losses. Loans and receivables are derecognised if the Company's contractual rights to the cash flows from the financial assets expire or if the Company transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset.

(n) Other receivables

Other receivables are stated at their cost less impairment losses (see accounting policy (p)).

(o) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Company’s cash management are included as a component of cash and cash equivalents for the purpose only of the statement of cash flows.

(p) Impairment

(i) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in the income statement. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred to the income statement.

(p) Impairment (continued)

(i) Financial assets (continued)

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in the income statement. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in other comprehensive income.

(ii) Non-financial assets

The carrying amounts of the Company's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit").

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(q) Financial liabilities

Financial liabilities include payables to related parties and interest-bearing loans and borrowings and also bank overdrafts and other payables. Financial liabilities are recognised in the statement of financial position when the Company becomes a party to the contractual provisions of the financial instrument. Interest-bearing loans and borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing loans and borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the year of the borrowings on an effective interest basis.

The directors have determined that the carrying amounts of bank overdrafts and other payables reasonably approximate their fair values because these liabilities are mostly short term in nature or are repriced frequently. Financial liabilities are derecognised if the Company's obligations specified in the contract expire or are discharged or cancelled.

(r) Derecognition and offset of financial assets and liabilities

A financial asset (or where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired; or
- the Company retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass through" arrangement; or
- the Company has transferred its rights to receive cash flows from the asset and has either transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Significant accounting policies

(s) Provisions

A provision is recognised in the statement of financial position if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(t) Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

(u) Dividends

Dividends payable on ordinary shares are recognised when they are paid.

1 Accounting estimates and judgements

The most critical judgements and estimates made by the Company are those regarding reported and unreported claims, deferred policy acquisition costs and defined benefit obligations.

Outstanding claims and provisions

The Company establishes reserves in respect of the anticipated losses incurred in respect of business it has written. These reserves reflect the expected ultimate cost of settling claims occurring prior to the statement of financial position date, but remaining unsettled at that time, and take into account any related reinsurance recoveries. Such reserves are established separately for each line of business written by the Company and fall into two categories – reserves for reported claims and reserves for losses incurred but not reported as of the statement of financial position date.

Reserves for reported claims are established on a case-by-case basis and are based largely on past experience of settlements on similar claims. The reserves are set on an undiscounted basis and reflect the anticipated cost of final settlement, taking into account inflation and other factors which might influence the final outcome. Such reserves are reviewed on a regular basis to take account of changing circumstances, such as changes in the law and changes in costs relating to settlement.

Reserves for claims incurred but not reported as of the statement of financial position date are also established on an undiscounted basis. They are estimated based on historical data using various actuarial techniques and statistical modelling methodologies. As with case reserves, reserves for claims incurred but not reported are calculated separately for each line of business written and take into account trends in settlement costs in arriving at the final estimates.

For further details on claims reserves see note 17.

Deferred acquisition costs

A proportion of the commission expenses and other acquisition costs incurred by the Company in respect of both new and renewal business written in the year are deferred as at the statement of financial position date. Such amounts deferred are then amortised over the estimated remaining period of the policies concerned. The extent to which costs are deferred is dependent on the directors' judgement as regards the level of costs incurred which relate to the business written.

For further details on deferred acquisition costs see note 14.

Defined benefit obligations

The Company’s liability for defined benefit obligations is based on various estimates including discount rates, expected returns on plan assets, future salary increases, future pension increases, mortality rates and future staff turnover. Differences in future actual experience may result in the balance recorded in the Company’s statement of financial position proving to be either too high or too low.

For further details on defined benefit obligations see note 24.

2 Risk management

Objectives and policies for mitigating business risk

The Company has identified the following risk areas: insurance, market, credit, liquidity, operational and capital management. The Company has various procedures in place to manage these exposures. These procedures have been embedded into decision making processes and the culture of the business. They include an overall risk management framework together with a set of clearly defined risk policies which articulate the Company's risk appetite. The Company also maintains a comprehensive risk register which identifies the individual risks faced in each area of the business and the controls in place to mitigate these. The Company's Risk Committee meets regularly to review both the risk policies and the risk register, to ensure they are up-to-date, reflecting the risks currently facing the business and that corresponding control issues and risk mitigation actions are being addressed in a timely manner. Reports from the Risk Committee are provided to both the Company's Board and Ageas (UK)'s Audit & Risk Committee.

(i) Insurance risk

The Company's primary insurance business is the assumption of risk of loss from individuals or businesses directly subject to the risk. The classification of insurance risks are underwriting, claims reserving, claims management and reinsurance.

(a) Underwriting risk

Underwriting risk occurs when the underwriter binds a policy at a given price and obliges the Company to pay claims under certain specified conditions, thus exposing the Company to the risk that the policy was not priced correctly due to underestimating the frequency and/or severity of the claims. Underwriting risk is at the core of the Company's business and is a major source of exposure for the Company's capital. The systems and controls required to manage and control this area of risk are therefore of critical importance.

The Company's objectives for underwriting risk are to achieve year on year growth in line with the strategic plan, subject to market conditions, deliver the required return on capital and maintain or widen the range of products in order that growth and return on capital are met.

The Company's business lines are generally characterised by large numbers of policyholders with homogeneous exposures, such as motor, household, travel and small commercial lines. The approach to pricing these products is based on the Company's knowledge and the price is given to the market not to individuals. Therefore underwriting is tightly controlled. The main technique to determine the price to be charged is to use past exposures, historical losses (plus an appropriate IBNR allowance) and external data sources as a basis for developing proposed premiums. Appropriate adjustments are made to reflect anticipated future conditions, expenses and the required profit margin. The performance of each business line is constantly monitored to identify new trends caused by distribution and cause or value of loss so that corrective pricing action can be implemented.

The Company reinsures a portion of the risks it underwrites in order to control its exposures to losses and protect capital resources. The Company buys primarily excess of loss (i.e. non-proportional) reinsurance treaties to reduce its net exposure to agreed levels for each line of business in accordance with the Company's risk appetite. In addition, the Company will buy facultative reinsurance on individual risks in certain specified circumstances. There are also occasions when quota share reinsurance is placed as part of a larger overall transaction.

2 Risk management (continued)

(a) Underwriting risk (continued)

Concentrations of insurance risk

A key aspect of the insurance risk faced by the Company is the degree of concentration of insurance risk, which may exist where a particular event or series of events could impact significantly upon the Company's liabilities. Such concentrations may arise from a single insurance contract or through a small number of related contracts, and relate to circumstances where significant liabilities could arise.

Concentrations of risk can arise in both high-severity, low frequency events, such as natural and other disasters and in situations where underwriting is biased towards a particular group, such as a particular geographical concentration or demographic trend.

High-severity, low frequency concentrations

The timing and frequency of high severity events are, by their nature, uncertain. They represent a material risk as the occurrence of such an event would have a significant adverse impact on the Company's cash flows and profitability.

The Company manages these risks by making appropriate allowance within the price calculated by underwriters and by purchasing a reinsurance programme that limit the impact of these events. The Company uses non-proportional reinsurance treaties to manage retention levels and the limits of protection.

Geographic and demographic concentrations

Material geographical concentrations of risk can exist in property portfolios such that natural perils of windstorm and floods may give rise to a large number of material damage and business interruption claims. The Company models its exposure to this risk to estimate its probable maximum loss and purchases reinsurance to significantly reduce its exposure to such events.

Material concentrations of risk may be created by specific distribution channels that target certain age ranges, affinity groups or underwriting strengths in certain geographic locations.

Economic downturn

The Company's insurance portfolio exposes it to a potential accumulation of different risks in the event of an economic recession. The Company's strategy in a recession is to ensure that premiums reflect the additional risks and exposures to those areas that could be adversely impacted by an economic downturn. It also monitors economy related claims closely to identify any that may be exaggerated or fraudulent.

Total aggregate exposure

The Company identifies the total aggregate exposure that it is prepared to accept in relation to concentrations of risk. It monitors these exposures on a regular basis by reviewing reports which show the key aggregations to which the Company is exposed. The Company uses a number of modelling tools to monitor aggregation and to simulate catastrophe losses in order to measure the effectiveness of the reinsurance programmes, and to quantify the net exposure to which the Company is exposed. Additional stress and scenario tests are run using these models during the year.

Delegated underwriting authorities

The Company has a number of delegated underwriting authorities with third parties. There is a risk that the third party does not have the controls, management information, quality of staff and technical skills to charge an appropriate price for the risk underwritten. Prior to contract the third party is subject to a due diligence process and is subsequently audited on a regular basis to ensure compliance with the contractual obligations and that the required levels of profitability are being achieved.

2 Risk management (continued)

(a) Underwriting risk (continued)

Third party injury claims

In recent years, the Company and the insurance market in general have experienced an increase in the frequency and value of third party injury claims, arising mainly in the private and commercial motor accounts.

These increases have been driven by an increased propensity for the population to be litigious and the extensive activities of companies actively persuading potential victims to instigate claims. The Company has recognised this trend and monitors its development closely, adjusting the prices of its products accordingly. The Company supports the aims of the Jackson Report to reform the rules on civil litigation costs that are now a major element of the cost of these claims.

(b) Claims reserving risk

Reserving and the ultimate cost of claims risk occurs where the Company's estimates of its insurance liabilities prove to be insufficient through inaccurate forecasting, additional expenses or reinsurance bad debts.

The methods used to estimate the insurance liabilities in respect of outstanding claims and provisions are detailed in note 1 to the Financial Statements. In addition an external independent actuary undertakes an annual review of large elements of the Company's reserves.

The aim of the reserving policy of the Company is to produce estimates of insurance liabilities that are accurate and reliable across each line of business and are consistent over the time period required to settle all the claims.

(c) Claims management risk

Claims management risk may arise in the event of inaccurate or incomplete case reserving or settlement, poor customer service or excessive costs of handling claims.

The Company's approach to claims management focuses upon creating a successful balance between satisfying the needs of the customer against control of the overall cost of the provision of the service that meets those needs. Customer includes both insured as well as others that believe our insured has breached a duty of care. The Company's philosophy is based upon the following principles:

- manufacturing claims – production commences at first notification of a loss where the components to satisfy a customer's claim are taken;
- predicament management – tailoring our service to meet the individual customer's needs; and
- reducing failure demand – failure demand is caused by a failure to do something right for the customer.

These principles support the Company's objectives to:

- create empathy with the customer and to offer processes that successfully deal with the resolution of their individual predicament not just their damaged assets;
- provide claims settlement that treats customers fairly, reflects policy and legal liability and complies fully with all other regulatory requirements;
- exercise control over claims reserves, indemnity claims costs, subrogated recoveries and payments to other parties; and
- exercise control over the expense costs associated with handling and settling claims.

(d) Reinsurance risk

Reinsurance is placed to reduce the Company's exposure to specific risks, events and accumulations. The risk is that the reinsurance contracts fail to perform as planned and do not reduce the gross cost of claims in terms of the limits purchased, either by risks not being appropriately covered or because there are gaps in the programme. The reinsurance programme is subject to considerable scenario planning, including by our brokers, and is approved by the Board.

The failure of a reinsurer to pay a claim is categorised as a credit risk.

(ii) Market risk

Market risk is the risk of change in the fair value of financial assets due to changes in interest rates, foreign exchange rates and debt security market values.

2 Risk management (continued)

(d) Reinsurance risk (continued)

Interest rate risk

The Company's exposure to changes in interest rates is primarily concentrated in its investment portfolio. To mitigate changes in interest rates the Company holds the material proportion of its investments in fixed rate debt securities. It will normally hold these securities to their maturity. This reduces the variation in future cash flows and provides security over future income and redemption values.

The company is also exposed to interest rate risk on the £40.0m subordinated debt it has issued, as the interest rate is based on LIBOR.

Foreign exchange risk

The risk is that the Company is exposed to increases in liabilities as a result of changes in exchange rates.

All the Company's premiums are currently received in Pounds Sterling.

The Company has US Dollar liabilities in respect of the run off of its former Marine and City business. These liabilities are matched on a half-yearly basis with currency assets.

The Company is also exposed to current travel policy claims that require settlement in US Dollars and Euros. These are normally settled in a short period from notification of the loss. Purchases of currency are made to cover the estimated requirement for current liabilities.

Debt security price risk

The Company is exposed to changes in the market values of debt securities for reasons other than changes in interest rates. This may be due to the credit rating changes, anticipated future interest rate changes, trading performance or market sentiment relating to the issuer.

The Company mitigates this risk by investing in high level of quality issuers in line with its investment strategy and normally holding debt securities until their maturity.

(iii) Credit risk

Credit risk is where counterparties fail to meet their obligations in full as they fall due. The main sources of credit risk are:

- Investments
- Brokers and intermediaries
- Reinsurers
- Other financial assets

The Company has a Credit Risk Committee that monitors the different exposure, rating and accumulation risks. It will make recommendations on amendments to policies to reduce risk. The maximum exposure is equal to the carrying amount of those assets.

Investments

The risk is managed within the Company's investment guidelines by the Investment Committee who regularly update the Board. The risk appetite from investments is low as the return is required to meet future liabilities arising from the Company's insurance risk. The investments are held in a high quality, fixed income portfolio and are normally held until maturity.

The analysis of the Standard and Poor credit ratings of the portfolio is as follows:

	2012	2012	2011	2011
	£m	%	£m	%
AAA	707.7	56.5	831.2	62.7
AA	157.9	12.6	172.4	13.0
A	315.3	25.2	257.3	19.4
BBB	71.4	5.7	65.0	4.9
Total	1,252.3	100.0	1,325.9	100.0

An analysis of fixed income securities and other investments is shown in note 16.

2 Risk management (continued)

(d) Reinsurance risk (continued)

Agents, brokers and intermediaries

The Company only trades through intermediaries who have been subject to a rigorous credit risk assessment and appointment procedure. All intermediaries are regulated by the FSA (with the exception of those located on the Isle of Man and the Channel Islands).

The levels of debt are regularly monitored and appropriate action is taken in respect of slow and non-payment within the terms of credit. The level of bad debts in the current and prior years was negligible.

	2012 £m	2012 %	2011 £m	2011 %
Within terms	134.3	93.8	134.5	95.8
0 - 1 month	6.5	4.5	4.4	3.1
2 months	1.6	1.1	0.7	0.5
3 months and above	0.9	0.6	0.9	0.6
Total	143.2	100.0	140.5	100.0

Reinsurance

The Company is exposed to credit risk through its reinsurance arrangements, where amounts due under a reinsurance contract may not be paid. The Company manages this risk by using only A- grade (or better) reinsurers (although ratings may subsequently fluctuate), or group companies supported by parent guarantee. Any alternative reinsurance arrangements are required to be ratified by the Board. The ratings of reinsurers are monitored by the Credit Risk Committee.

Other financial assets

The credit risk arising from the other financial assets of the Company - comprising cash and cash equivalents, instalments and other receivables, but excluding related party balances - is from the default of the counterparty. Default on instalment payments results in the Company cancelling the underlying policy in order to reduce its exposure.

An analysis of insurance and other receivables is shown in note 19.

(iv) Liquidity risk

The Company is exposed to liquidity risks arising from daily calls on its cash resources, notably from claims arising on its insurance contracts. There is therefore a risk that cash will not be available to settle liabilities when due.

The liquidity risk needs to be balanced against the aim to match the maturity of financial assets with the estimate of the settlement of insurance liabilities and also optimise the yield on the investment portfolio.

The Company manages its liquidity risk by having investment guidelines that it maintains sufficient liquidity or its financial assets can be realised at short notice in the event of a major event or catastrophe. The Company may also make use of borrowing facilities if required.

Claims liabilities - Estimated payment profile

Payment period	2012 £m	2012 %	2011 £m	2011 %
0 - 1 year	426.0	43.9	401.2	44.4
2 - 5 years	476.1	49.1	427.8	47.3
5 years and above	68.0	7.0	75.5	8.3
Total	970.1	100.0	904.5	100.0

An analysis of insurance contract provisions is shown in note 17.

2 Risk management (continued)

(v) Operational risk

Operational risk arises from inadequate or failed internal processes, people and systems, or from external events. It is diverse in nature and permeates all business activities but remains a distinct form of risk.

The identification, assessment and evaluation, management, monitoring and reporting of risks rests with business managers. Risks are identified, assessed and scored; the Risk Committee reviews the risks on a regular basis and for those falling outside the Company's risk appetite monitors the remedial action to ensure compliance with the Company's risk appetite.

(vi) Capital management

Aims of capital management policy

The Company has established standards for the efficient management of capital, to meet the needs of the business and return on capital requirements of shareholders. This includes the capital required to support the risk appetite identified in the Company's Risk Policies together with an additional capital margin, in full compliance with the requirements of the FSA.

Definitions of capital management (and supporting terms)

Capital Management is the collection of processes and activities undertaken to ensure that sufficient capital is maintained to ensure the organisation's ability to meet its liabilities and ultimately ensure its survival, particularly in case of losses arising from adverse events.

Capital Management includes the assessment of capital required to support the Company's plans and objectives, the structure of its shareholders' funds, arrangements to secure capital, and the ongoing monitoring of capital against business requirements, as well as the assessments required by the FSA, minimum capital requirement (MCR), enhanced capital requirement (ECR), internal capital assessment (ICA) and individual capital guidance (ICG).

Approach to capital management

The Company develops an Operating Business Plan, which is a key component of the Ageas (UK) Strategic Plan, and is reviewed and revised each year and then formally approved by the Company's Board.

A key factor in the formulation of the Strategic Plan is the assessment of the capital required to support the business objectives (i.e. growth and profit targets) and the appropriateness of the supporting capital structure.

Overall capital requirements and structure are assessed taking account of the following:

- capital required to support the planned growth in new business and renewal premiums and profit targets;
- the required rate of return on capital employed;
- the required dividend;
- FSA capital requirements based on ECR and MCR formulae and ICA methodologies; and
- capital required to support the desired credit rating.

In the event of failure to meet the capital requirements, the Company would revert to its shareholders for an injection of funds to ensure compliance.

Capital reserves are in excess of 2.1 times the FSA's Minimum Capital Requirements.

For pricing/underwriting purposes, capital is allocated to different classes of business using a risk-based methodology. Where product lines do not have the potential to achieve the required return on capital within the plan period the Company will consider divestment.

(viii) Sensitivity to key business drivers

The impact of the changes in key business drivers is each assumed to be a discrete change. All other factors will be unchanged.

Some of these changes cannot be guaranteed to have a linear effect and as a whole range of other factors will impact the results they cannot be guaranteed to predict the detailed result. In addition the risk management that the Company operates will ensure that corrective action is implemented to mitigate or reverse the changes.

The sensitivities below have been highlighted based on the significant effect they have on the profitability of the company.

2 Risk management (continued)

(viii) Sensitivity to key business drivers (continued)

Interest yields decrease by 1.0%

The Company will be exposed to the impact of interest yield changes on its financial assets and liabilities. There would be a reduction in income on short-term cash balances and an increase in the market value of fixed interest debt securities. As the Company will normally hold its fixed interest debt securities to maturity, it will not suffer any reduction in its future cash flow. It will suffer a reduction in the yield on any future fixed interest debt securities that it purchases from surplus funds and the maturity of current investments. There would also be a reduction in the interest payable on the subordinated debt.

Forecasting the impact on the market values of fixed interest debt securities will not be linear due to other factors including credit rating movement, anticipation of future interest rate changes, trading performance or market sentiment of the issuers.

	2012 £m	2011 £m
Reduction in profit	(1.5)	(3.1)
Increase in net assets	10.4	10.5
Total increase in net assets before tax	8.9	7.4

Expenses increase by 5.0%

If all three expense areas (acquisition, administration and claims) were to increase by 5.0% each, in addition to the impact on profit of the additional costs, it will also increase the claims handling provision and the deferred acquisition costs to the extent that these will be recovered by unearned premiums.

	2012 £m	2011 £m
Total impact on profit before tax	5.0	4.2
Total impact on net assets before tax	5.0	4.2

Gross loss ratio increases by 1.0%

If the cost of claims were to increase the gross loss ratio (gross incurred claims as a proportion of gross earned premium) by 1.0% there would be a reduction in profits. It is assumed that a similar portion of claims costs would be recoverable from reinsurers. There would also be an increase in claims handling reserve as a proportion of the claims would be unpaid at the statement of financial position date.

	2012 £m	2011 £m
Total impact on profit before tax	10.6	8.8
Total impact on net assets before tax	10.6	8.8

3 Premiums

	2012 £m	2011 £m
Gross written premiums	1,097.1	1,066.1
Change in the gross provision for unearned premiums	(13.1)	(60.7)
Gross insurance premium revenue	1,084.0	1,005.4
less: Written premiums ceded to reinsurers	(80.2)	(63.1)
less: Reinsurers’ share of change in the provision for unearned premiums	5.5	1.0
Ceded earned premiums	(74.7)	(62.1)
Net insurance premium revenue	1,009.3	943.3

Notes to the financial statements

4 Commission income

	2012 £m	2011 £m
Reinsurance commission	4.7	3.9
Total commission income	4.7	3.9

5 Investment income

	2012 £m	2011 £m
Interest income:		
- Available-for-sale interest income	37.9	40.9
- Loans and receivables interest income	1.7	0.6
Dividend income from subsidiary companies	0.2	0.0
Net realised gains from available-for-sale financial assets	9.2	6.0
Total investment income	49.0	47.5

6 Other operating income

	2012 £m	2011 £m
Engineers' income	7.3	5.8
Instalment service charge income	0.9	1.1
Other income	14.7	13.9
Total other operating income	22.9	20.8

7 Claims and benefits incurred

	2012 £m	2011 £m
Current year claims paid	(361.4)	(333.6)
Change in prior years claims	26.0	(2.3)
Claims handling costs	(33.6)	(32.3)
Additional liabilities arising during the year	(386.5)	(372.4)
Net foreign exchange differences	(0.6)	(0.2)
Total claims and benefits incurred	(756.1)	(740.8)

8 Acquisition costs

	2012 £m	2011 £m
Commission expenses payable	(212.9)	(203.8)
Other acquisition costs payable	(48.5)	(45.9)
Changes in deferred acquisition costs	5.3	13.4
Total acquisition costs	(256.1)	(236.3)

9 Operating expenses

	2012 £m	2011 £m
Depreciation and amortisation:		
- Leasehold buildings	(0.1)	(0.1)
- Equipment and motor vehicles	(0.5)	(0.5)
- IT equipment	(2.4)	(2.0)
Personnel expenses:		
- Wages and salaries	(47.9)	(43.9)
- Compulsory social security contributions	(4.3)	(4.1)
- Contributions to defined benefit plans	(7.7)	(8.1)
- Contributions to defined contribution plans	(2.6)	(2.2)
- Reduction/(increase) in liability for defined benefit plans	2.4	4.7
Goods and services	(15.2)	(13.0)
Software costs	(10.0)	(9.5)
Other costs	(20.7)	(13.4)
Total operating expenses	(109.0)	(92.1)

Operating expenses are analysed as:		
Acquisition costs	(51.4)	(45.9)
Administration costs	(24.0)	(14.0)
Claims handling costs	(33.6)	(32.2)
	(109.0)	(92.1)

Auditor's remuneration

Auditor's remuneration is included within goods and services costs above.

Fees payable to the Company's auditors for the audit of the annual financial statements were £92,000 (2011: £92,000) and regulatory reporting were £46,000 (2011: £46,000).

Fees payable to the Company's auditors for other goods and services were £14,000 (2011: £nil).

10 Finance costs

	2012 £m	2011 £m
Interest expense	(2.5)	-
Total finance costs	(2.5)	-

11 Income taxes

Recognised in the statement of comprehensive income

	2012 £m	2011 £m
Current tax		
Current year – operations	(17.7)	(11.3)
Adjustments for prior years	2.5	(2.5)
	(15.2)	(13.8)
Deferred tax expense		
Origination and reversal of temporary differences	(2.2)	(4.0)
Total income tax	(17.4)	(17.8)

11 Income taxes (continued)

Reconciliation of effective tax rate

The tax assessed on the year is higher (2011: higher) than the standard rate of Corporation tax in the United Kingdom of 24.5% (2011: 26.5%). The differences are explained below:

	2012 £m	2011 £m
Profit/(loss) on ordinary activities before tax	64.7	66.6
Profit on ordinary activities at the standard rate of corporation tax in the UK	(15.9)	(17.6)
Expenses not deductible for tax purposes	(1.8)	(0.1)
Effect of variable rates	0.5	0.1
	(17.2)	(17.6)
Adjustments in respect of prior years	(0.2)	(0.2)
	(17.4)	(17.8)

Tax recognised directly in equity

	2012 £m	2011 £m
Deferred tax	-	8.2
Corporation tax	(3.4)	(13.7)
	(3.4)	(5.5)

12 Non-recurring administrative expenses

£6,000,000 of the non-recurring expenses is a provision to cover the anticipated costs of merging the operations of Ageas Insurance Limited with those of Groupama Insurance Company Limited within the next 12 months. The provision is based on a best estimate of the total cost of customer communications, legal and professional fees and reorganisation costs. Additionally, in the year, an exceptional provision for £1,033,348 was made in relation to onerous lease contracts arising from the planned move to new Head Office premises and the subsequent rationalisation of leasehold property commitments. The onerous lease contracts have been based on the value of rents payable on unutilised office space, with no assumed rents receivable from sub-letting. The remaining £3,005,432 of the non-recurring administrative expenses is a provision against the negative retained earnings held in the Company's wholly owned subsidiary Bishopsgate Head Office Limited ('Bishopsgate'), as a result of writing down the value of Ageas House, owned by Bishopsgate, to market value.

13 Property, plant and equipment

	Land and buildings £m	Leasehold buildings and improvements £m	Equipment and motor vehicles £m	IT equipment £m	Total £m
Cost					
Balance at 1 January 2011	-	1.2	3.1	13.2	17.5
Acquisitions	-	0.0	0.5	3.2	3.7
Disposals	-	-	-	-	-
Balance at 31 December 2011	-	1.2	3.6	16.4	21.2
Acquisitions	12.4	-	0.3	1.9	14.6
Disposals	-	-	(0.1)	-	(0.1)
Balance at 31 December 2012	12.4	1.2	3.8	18.3	35.7
Depreciation and impairment losses					
Balance at 1 January 2011	-	0.1	2.1	9.4	11.6
Depreciation charge for the year	-	0.1	0.5	2.0	2.6
Disposals	-	-	-	-	-
Balance at 31 December 2011	-	0.2	2.6	11.4	14.2
Depreciation charge for the year	-	0.1	0.5	2.4	3.0
Disposals	-	-	(0.1)	-	(0.1)
Balance at 31 December 2012	-	0.3	3.0	13.8	17.1
Carrying amounts					
Balance at 31 December 2011	-	1.0	1.0	5.0	7.0
Balance at 31 December 2012	12.4	0.9	0.8	4.5	18.6

14 Deferred acquisition costs

As part of the Company's insurance business, certain acquisition costs are deferred.
An analysis of these deferred costs is set out below:

	2012 £m	2011 £m
Balance at 1 January	121.3	108.0
Acquisition costs incurred in year	261.4	249.6
Amortisation charged to income	(256.1)	(236.3)
Balance at 31 December	126.6	121.3

15 Investments in subsidiaries

	2012 £m	2011 £m
Investments in subsidiaries are stated at cost		
At 1 January and 31 December	0.0	0.4

The following companies, which are incorporated in the United Kingdom, were subsidiaries at 31 December 2011 and 31 December 2012.

Company	**Activity**	**% Owned**
Bishopsgate Head Office Ltd	Property holding	100

Ageas Services (UK) Limited, a 100% owned subsidiary of Ageas Insurance Limited, was sold at its cost value on 1 October 2012 for £434,583. It was sold to Ageas (UK) Limited, its immediate parent.

Notes to the financial statements

16 Financial Investments

Available-for-sale

	2012	2011
	£m	£m
Debt securities - fixed rate		
UK Government bonds	318.1	350.1
Non UK Government bonds	1.6	7.6
Supranational / Agency bonds	431.1	508.6
Corporate bonds	501.5	459.6
	1,252.3	1,325.9
Fixed term deposits	40.1	-
Total financial Investments	1,292.4	1,325.9

Available-for-sale

The movements in financial investments are as follows:

	2012	2011
	£m	£m
Balance at 1 January	1,325.9	1,203.4
Foreign exchange/translation differences	(0.5)	(0.1)
Additions	232.5	518.0
Sales and redemptions	(291.1)	(432.4)
Fair value unrealised gains and losses	10.7	24.0
Amortisation of premiums and discounts	14.9	13.0
Balance at 31 December	1,292.4	1,325.9

As at 31 December 2012 the current portion of financial investments is £115.5m (2011: £154.5m) and the non-current portion is £1,176.9m (2011: £1,171.4m).

The effective interest rate at the statement of financial position date on sterling assets available-for-sale is 2.8% (2011: 3.1%) and on US Dollar assets is 4.3% (2011: 4.5%).

The Company does not have direct exposure to sovereign debt other than to the UK and US government, and indirect exposure is carefully managed through conservative investment guidelines.

Valuation of financial instruments

The Company measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- level 1: Quoted market price (unadjusted) in an active market for an identical instrument.
- level 2: Valuation techniques based on observable inputs, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using quoted market prices in active markets for similar instruments, quoted prices for similar instruments in markets that are considered less than active, or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. The category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

16 Financial Investments (continued)

Available-for-sale (continued)

The table below analyses financial instruments, measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value measurement is categorised:

2012	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Financial investments	319.7	972.7	-	1,292.4
	319.7	972.7	-	1,292.4

2011	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Financial investments	357.7	968.2	-	1,325.9
	357.7	968.2	-	1,325.9

There have been no significant transfers between levels 1 and 2 during the year.

17 Insurance contract provisions and reinsurance assets

	2012			2011		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
	£m	£m	£m	£m	£m	£m
Unearned premiums	522.3	(15.1)	507.2	509.2	(9.6)	499.6
Claims reported by policy holders	777.2	(99.4)	677.8	739.6	(110.9)	628.7
Claims incurred but not reported	192.7	(13.9)	178.8	164.9	(3.3)	161.6
Total insurance contract provisions	1,492.2	(128.4)	1,363.8	1,413.7	(123.8)	1,289.9

Recoveries are not included above. For details see subsection (iii).

Liability insurance contracts underwritten by the Company in the past expose the Company to claims in the US from industrial diseases caused by exposure to asbestos. These liabilities comprise one percent of the Company's general insurance liabilities at 31 December 2012. The assumptions used in determining the liabilities are included in analysis (iv).

(i) Analysis of movements in insurance provisions

	2012			2011		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
	£m	£m	£m	£m	£m	£m
Balance at 1 January	1,413.7	(123.8)	1,289.9	1,310.1	(115.0)	1,195.1
Claims paid/recovered from reinsurers	(656.0)	28.4	(627.6)	(664.3)	34.4	(629.9)
Movement in claims incurred but not	27.8	(10.6)	17.2	(25.7)	19.1	(6.6)
Claims reported in the period	693.6	(16.9)	676.7	733.0	(61.3)	671.7
Change in provision for unearned	13.1	(5.5)	7.6	60.6	(1.0)	59.6
Balance at 31 December	1,492.2	(128.4)	1,363.8	1,413.7	(123.8)	1,289.9

(ii) Analysis of movements in provision for gross unearned premium

	2012	2011
	£m	£m
Balance at 1 January	509.2	448.5
Written premiums during the year	1,097.1	1,066.1
Less: premiums earned during the year	(1,084.0)	(1,005.3)
Balance at 31 December	522.3	509.3

17 Insurance contract provisions and reinsurance assets (continued)

(iii) Analysis of movements in outstanding claims

	2012 £m	2011 £m
Gross outstanding claims		
Balance at 1 January	904.5	861.4
Current year claims incurred	759.4	717.1
Change in prior year claims incurred	(37.8)	(9.7)
Current year claims paid	(361.4)	(333.6)
Previous year claims paid	(294.6)	(330.7)
Balance at 31 December	970.1	904.5
Salvage and subrogation recoveries (note 18)		
Balance at 1 January	(16.0)	(17.2)
Current year claims	(11.3)	(10.8)
Change in prior year claims	11.8	12.0
Balance at 31 December	(15.5)	(16.0)
Gross claims outstanding net of recoveries		
Balance at 1 January	888.5	844.2
Current year claims	747.9	706.3
Change in prior year claims	(26.0)	2.3
Current year claims paid	(361.4)	(333.6)
Prior year claims paid	(294.6)	(330.7)
Balance at 31 December	954.4	888.5

(iv) Process used to determine the assumptions

The sources of data used as inputs for the assumptions behind insurance provisions are internal, using detailed studies that are carried out annually. The assumptions are checked to ensure that they are consistent with observable market prices or other published information. There is more emphasis on current trends, and where in early years there is insufficient information to make a reliable best estimate of claims development, prudent assumptions are used.

The nature of the business makes it very difficult to predict with certainty the likely outcome of any particular claim and the ultimate cost of notified claims. Each notified claim is assessed on a separate, case by case basis with due regard to the claim circumstances and historical evidence of the size of similar claims. Case estimates are reviewed regularly and are updated as and when new information arises. The provisions are based on information currently available. However, the ultimate liabilities may vary as a result of subsequent developments. The impact of many of the items affecting the ultimate costs of the loss is difficult to estimate. The degree of complexity involved will also differ by book of business due to differences in the underlying insurance contract, claim complexity, the volume of claims and the individual severity of claims, determining the occurrence date of a claim, and delayed reporting by policyholders.

For the Company’s exposure to asbestos, environmental pollution and latent injury damage, claims arise from policies written under which the Company has assumed liabilities, on an indemnity or assumption basis. The Company’s estimate of its ultimate liability for such exposures includes case estimate provisions and a provision for liabilities incurred but not reported. The provision for liabilities incurred but not reported is established based on various methods such as loss development patterns and frequency and severity trends.

Estimation of ultimate liabilities for asbestos and environmental exposures is inherently difficult due to several significant issues surrounding such exposures. Among the issues are: (a) the long period between exposure and manifestation of an injury, (b) difficulty in identifying the sources of asbestos or environmental contamination, (c) difficulty in allocating responsibility or liability for asbestos or environmental damage, (d) changes in underlying laws and judicial interpretation of those laws, and (e) uncertainty regarding the identity and number of parties insured with potential asbestos or environmental exposure.

17 Insurance contract provisions and reinsurance assets (continued)

(iv) Process used to determine the assumptions (continued)

For all other risks, the cost of outstanding claims and the IBNR provisions are estimated using various statistical methods. Such methods extrapolate the development of paid and incurred claims, average cost per claims and ultimate claim numbers for each accident year based upon observed development of earlier years and expected loss ratios.

The key methods, which remain unchanged from prior years, are:

- chain ladder methods, which use historical data to estimate the paid and incurred to date proportions of the ultimate claim cost;
- expected loss ratio methods, which use the Company's expectation of the loss ratio for a class of business; and
- benchmarking methods, which use the experience of comparable, more mature, classes to estimate the cost of claims.

The actual method or blend of methods used varies by accident year being considered, the class of business and observed historical claims development.

To the extent that these methods use historical claims development information they assume that the historical claims development pattern will occur again in the future. There are reasons why this may not be the case, which, insofar as they can be identified, have been allowed for by modifying the methods. Such reasons include:

- changes in processes that affect the development/recording of claims paid and incurred (such as changes in claim reserving procedures);
- economic, legal, political and social trends (resulting in, for example, a difference in expected levels of inflation);
- changes in mix of business; and
- random fluctuations, including the impact of large losses.

IBNR provisions are initially estimated at a gross level and a separate calculation is carried out to estimate the size of reinsurance recoveries. The Company is covered by a variety of excess of loss reinsurance programmes. The method used by the Company takes historical data, gross IBNR estimates and details of the reinsurance programme, to assess the expected size of reinsurance recoveries.

The Company's reserves for asbestos and environmental related losses arise from business written for accident years 1986 and prior. The Company has minimal exposure in the more recent accident years. The key assumptions affecting the measurement of the provisions are (a) continued growth in the number of claims filed due to a more aggressive plaintiff's bar, and (b) increase in claims involving defendants formerly regarded as peripheral.

The Company believes that the liability for claims reported in the statement of financial position is adequate. However, it recognises that the process of estimation is based upon certain variables and assumptions, which could differ when claims arise.

The reserves are net of recoveries from salvage and subrogation. These recoveries are estimated on the probability of the recovery being made and are subject to regular review.

(v) Analysis of claims development – gross of reinsurance and net of salvage and subrogation recoveries

	Accident year					
	2008	2009	2010	2011	2012	Total
	£m	£m	£m	£m	£m	£m
Gross estimate of cumulative claims						
At end of accident year	588.7	631.6	696.6	706.1	747.9	3,370.9
- one year later	10.1	16.2	18.4	(7.3)	-	37.4
- two years later	(4.1)	1.5	(11.7)	-	-	(14.3)
- three years later	4.9	9.4	-	-	-	14.3
- four years later	(2.9)	-	-	-	-	(2.9)
Estimate of cumulative claims	596.7	658.7	703.3	698.8	747.9	3,405.4
Cumulative payments to date	(545.5)	(564.3)	(594.2)	(502.7)	(361.4)	(2,568.1)
Provision for prior years	-	-	-	-	-	117.1
Gross outstanding claims liabilities	51.2	94.4	109.1	196.1	386.5	954.4

17 Insurance contract provisions and reinsurance assets (continued)

(vi) Analysis of claims development – net of reinsurance and net of salvage and subrogation recoveries

	Accident year					
	2008	2009	2010	2011	2012	Total
	£m	£m	£m	£m	£m	£m
Net estimate of cumulative claims						
At end of accident year	581.4	622.5	662.6	669.8	719.7	3,256.0
- one year later	6.1	10.9	13.3	(7.9)	-	22.4
- two years later	(0.6)	2.5	(11.6)	-	-	(9.7)
- three years later	4.7	6.5	-	-	-	11.2
- four years later	(0.8)	-	-	-	-	(0.8)
Estimate of cumulative claims	590.8	642.4	664.3	661.9	719.7	3,279.1
Cumulative payments to date	(543.8)	(557.7)	(566.5)	(486.9)	(351.8)	(2,506.7)
Provision for prior years	-	-	-	-	-	68.5
Net outstanding claims liabilities	47.0	84.7	97.8	175.0	367.9	840.9

18 Deferred tax

The Finance Act 2012 enacted corporation tax rates of 24% from 1 April 2012 and 23% from 1 April 2013. On 11 December 2012 it was announced that the rate from 1 April 2014 will be 21%, and on 20 March 2013 it was announced that the rate from 1 April 2015 will be 20%. These rate changes are not enacted. The 23% rate has been enacted and has been taken into consideration in the deferred tax calculation.

Recognised deferred tax

Deferred tax assets are attributable to the following:

	2012	2011
	£m	£m
Property, plant and equipment	0.4	1.1
Equalisation provision	(4.2)	(2.3)
Employee benefits	(3.1)	(2.7)
Provisions	1.8	1.0
Tax liabilities	(5.1)	(2.9)

There are no unrecognised deferred tax assets or liabilities.

Movement in temporary differences during the year

	1 Jan 2012	Recognised in income	Recognised in equity	31 Dec 2012
	£m	£m	£m	£m
Property, plant and equipment	1.1	(0.7)	-	0.4
Equalisation provision	(2.3)	(1.9)	-	(4.2)
Employee benefits	(2.7)	(0.4)	-	(3.1)
Provisions	1.0	1.8	-	2.8
Losses	-	(1.0)	-	(1.0)
Tax assets / (liabilities)	(2.9)	(2.2)	-	(5.1)

	1 Jan 2012	Recognised in income	Recognised in equity	31 Dec 2012
	£m	£m	£m	£m
Property, plant and equipment	0.7	0.4	-	1.1
Unrealised appreciation:				
- Financial assets	(8.2)	-	8.2	-
Equalisation provision	(4.3)	2.0	-	(2.3)
Employee benefits	(1.6)	(1.1)	-	(2.7)
Provisions	-	1.0	-	1.0
Losses	6.3	(6.3)	-	-
Tax assets / (liabilities)	(7.1)	(4.0)	8.2	(2.9)

The deferred income tax recognised in equity in the prior year relates to unrealised movements on available-for-sale financial assets.

19 Insurance and other receivables

	2012 £m	2011 £m
Receivables arising from insurance contracts:		
- contract holders	26.3	25.4
- agents, brokers and intermediaries	108.8	101.8
- reinsurers	8.1	13.3
Total receivables arising from insurance contracts	143.2	140.5
Amounts due from group undertakings	41.2	51.7
Salvage and subrogation recoveries	15.5	16.0
Other receivables and pre-payments	2.1	25.3
Accrued interest income	17.0	22.7
Deferred other charges	2.5	2.2
Other	0.1	0.1
Total insurance and other receivables	221.6	258.5

Amounts due from group undertakings include an unsecured loan facility to Bishopsgate Head Office Limited which is repayable on demand in cash. The interest rate on the loan is 1.75% (2011: 1.75%). All other amounts due from group undertakings are unsecured, interest free and repayable on demand in cash.

20 Cash and cash equivalents

	2012 £m	2011 £m
Cash at bank	13.5	13.5
Cash held with custodians	172.5	53.4
Cash and cash equivalents	186.0	66.9

The effective interest rate at 31 December 2012 on short term bank deposits was 0.5% (2011: 0.6%), with an average maturity of one day.

Included in cash and cash equivalents held by the Company as at 31 December 2012 are balances totalling £0.6m (2011: £0.6m) not available for use by the Company because they are held in trust to guarantee claims liabilities.

21 Loans and borrowings

	2012 £m	2011 £m
Current liabilities		
Unsecured bank facility	-	8.9
	-	8.9
Non-current liabilities		
Subordinated debt	40.0	-
	40.0	-
Total loans and borrowings	40.0	8.9

The unsecured bank facility, when utilised, bears interest at 1.5% (2011: 1.5%).

The subordinated debt is due to Ageas (UK) Limited, the company's immediate parent. The subordinated debt incurs interest at 3.5% above LIBOR, with the LIBOR rate being reviewed quarterly. Accrued interest is also payable quarterly. The subordinated debt is perpetual, and therefore carries no maturity date.

22 Insurance payables, other payables and deferred income

	2012 £m	2011 £m
Amounts due to group undertakings	17.0	7.5
Direct insurance contract payables	5.3	6.4
Other payables and accrued expenses	21.8	25.9
IPT, VAT and other taxes payable	24.2	21.8
Deferred income	0.4	0.4
Total insurance payables, other payables and deferred income	68.7	62.0

Deferred income represents amounts deferred under investment management service contracts that are recognised as revenue as the investment management services are provided.

Amounts due to group undertakings are unsecured, interest free and repayable on demand in cash.

23 Other provisions

	2012 £m	2011 £m
Balance at 1 January	0.6	2.8
Provisions made during the year	7.0	-
Provisions reversed during the year	(0.1)	(2.2)
Balance at 31 December	7.5	0.6

Provisions made during the year include an amount of £6,000,000 to cover the anticipated costs of merging the operations of Ageas Insurance Limited with those of Groupama Insurance Company Limited within the next twelve months. The provision is based on a best estimate of the total cost of customer communications, legal and professional fees and reorganisation costs. Additionally, in the year, a provision in the amount of £1,033,348 was made in relation to onerous lease contracts arising from the planned move to new Head Office premises and the subsequent rationalisation of leasehold property commitments. The onerous lease contracts have been based on the value of rents payable on unutilised office space, with no assumed rents receivable from sub-letting. Both of these items are show as non-recurring administrative expenses in the statement of comprehensive income, and are disclosed in note 12.

Other provisions include a liability for the cost of Company staff on long term sickness, together with a liability in relation to the unused Company staff annual leave entitlements.

24 Pension schemes

The Company operates a funded defined benefit pension scheme, the Ageas Insurance Staff Pension Scheme, in respect of staff who were members of the scheme on 31st December 1997 and staff of group companies who had contractual rights to join the scheme after this date. In 2001 active members of the Northern Star Insurance Company Limited Superannuation Fund, whose employment transferred to Ageas Insurance Limited, joined the scheme for future service on a benefit structure mirroring that in their previous scheme and were granted past service benefits in respect of a bulk transfer payment received from that scheme.

The assets of the scheme are held in a separate trust fund. Assets are invested under trustee guidelines. Contributions to the scheme are charged to the statement of comprehensive income so as to spread the cost of pensions over employees' working lives with the Company. The contributions are determined by a qualified actuary on the basis of triennial valuations using the projected unit method. A full actuarial valuation was carried out at 1st April 2010. At that date, the market value of the assets of the scheme amounted to £89,648,000 and was sufficient to cover 88.5% of the benefits that had accrued to members, after allowing for the expected future increases in earnings.

During the year the Company made certain changes to the pension scheme that were effective from 1 October 2012. Firstly, members not currently contributing are required to pay 5% of their salary, and members paying in an employee contribution of 5% to receive an enhanced rate of accrual, will need to increase their payment to 10%. Secondly, there has been a change to the basis on which pensions in payment increase for pensionable service. This will link the increases for future pension accrual to the statutory increases, which are currently CPI inflation subject to a maximum of 2.5% each year. Thirdly, there is an option on retiring to convert pension increases on pre-October 2012 benefits to a lower rate in exchange for a higher starting pension.

24 Pension schemes (continued)

The Company also operates a defined contribution scheme called Ageas Insurance Limited Group Pension Scheme in respect of other staff. The assets of the scheme are held separately from those of the Company in an independently administered fund. The pension cost in respect of members of this fund represents contribution payable by the Company to the fund and amounted to £2,629,771 (2011: £2,231,499).

The Company accounts for pension costs in accordance with IAS 19, Employment Benefits.

The formal valuation of the Ageas Insurance defined benefit pension scheme at 1st April 2010 has been updated by a qualified independent actuary on an IAS 19 basis at 31st December 2012. The major assumptions used by the actuary were:

	2012	2011	2010
Valuation Method	Projected unit	Projected unit	Projected unit
	%	%	%
Rate of increase in salaries	5.00	5.00	5.00
Rate of increase in pensions in payment:			
- Post 1988 Non GMP (ex Bishopsgate members)	5.00	5.00	5.00
- Post 1988 Non GMP (ex Northern Star members)	3.00	3.40	3.40
Discount Rate	4.05	4.30	5.25
Inflation assumption	3.00	3.00	3.00

	Asset mix - fair value	2012 Projected unit	2011 Projected unit	2010 Projected unit
Expected return on scheme assets:				
	%	%	%	%
Equities	70%	4.70	6.05	5.90
Corporate bonds	4%	2.50	3.45	3.85
UK government bonds	26%	2.00	2.25	2.90
Cash	0%	0.35	1.00	0.50

The future life expectancy assumptions for a current male pensioner aged 65 is 23.13 years, for a current female pensioner aged 65 is 24.96 years, for a future male pensioner aged 65 in 20 years from the accounting date is 23.36 years, and for a future female pensioner aged 65 in 20 years from the accounting date is 25.65 years.

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions, which, due to the timescale covered, may not necessarily be borne out in practice.

The defined benefit scheme is closed to new members. Under the projected unit method of valuing the liabilities of the scheme, the current service cost will increase as the members of the scheme approach retirement.

	2012 £m	2011 £m
Changes in the Present Value of the Obligations and in the Fair Value of Plan		
Present value of funded obligations at 1 January	132.8	105.4
Interest cost	5.6	5.5
Past service cost	-	-
Settlement	-	-
Current service cost	3.4	3.1
Member contributions	-	0.1
Benefits and other payments	(3.0)	(2.8)
Actuarial (gain) loss on obligation	8.1	21.5
Present value of funded obligations at 31 December	146.9	132.8
Fair value of scheme assets at 1 January	108.8	99.5
Expected return on scheme assets	5.3	5.3
Employer contributions	7.8	8.1
Member contributions	-	0.1
Benefits and other payments	(3.0)	(2.8)
Actuarial gain (loss) on scheme assets	4.4	(1.4)
Fair value of scheme assets at 31 December	123.3	108.8

24 Pension schemes (continued)

The history of experience gains and losses are as follows;

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Fair value of scheme assets	(123.3)	(108.8)	(99.5)	(82.1)	(66.1)
Present value of defined benefit obligations	146.9	132.8	105.4	102.5	80.0
Deficit in the scheme	23.6	24.0	5.9	20.4	13.9

	2012 £m	2011 £m
Limits of the corridor		
Net cumulative unrecognised actuarial gains (losses) at 1 January	(34.7)	(11.9)
Limits of "corridor" at start of year	(13.3)	(11.0)
Excess	(21.4)	(0.9)
Expected future working lifetime of employees participating in the scheme (years)	13.0	14.0
Actuarial (gain) loss recognised	1.7	0.1
Unrecognised actuarial gains (losses) at 1 January - obligation	(29.7)	(8.3)
Unrecognised actuarial gains (losses) at 1 January - scheme assets	(5.0)	(3.6)
Actuarial gain (loss) for the year - obligation	(8.1)	(21.5)
Actuarial gain (loss) for the year - scheme assets	4.4	(1.4)
Unrecognised actuarial gains and losses	(38.4)	(34.8)
Actuarial (gain) loss recognised - obligation	1.4	0.1
Actuarial (gain) loss recognised - scheme assets	0.2	0.0
Unrecognised actuarial gains (losses) at end 31 December	(36.8)	(34.7)
Unrecognised actuarial gains (losses) at 31 December - obligation	(36.6)	(29.7)
Unrecognised actuarial gains (losses) at 31 December - scheme assets	(0.2)	(5.0)
Unrecognised actuarial gains (losses) at 31 December	(36.8)	(34.7)

	2012 £m	2011 £m
Amounts recognised in the statements of financial position and comprehensive income		
Present value of the obligation at 31 December	146.9	132.8
Fair value of scheme assets at 31 December	(123.3)	(108.8)
	23.6	24.0
Unrecognised actuarial gains (losses) on obligations	(36.6)	(29.7)
Unrecognised actuarial gains (losses) on scheme assets	(0.2)	(5.0)
Unrecognised past service cost	-	-
(Asset) / liability recognised in statement of financial position	(13.2)	(10.7)
Current service cost	3.4	3.1
Past service cost	-	-
Interest cost	5.6	5.5
Expected return on plan assets	(5.3)	(5.3)
Net actuarial (gain) loss recognised during year	1.7	0.1
Expense recognised in the statement of comprehensive income	5.4	3.4
Opening net (asset)/ liability	(10.8)	(6.0)
Expense as above	5.4	3.4
Contributions paid	(7.8)	(8.1)
Closing net (asset) / liability	(13.2)	(10.7)
Expected return on scheme assets	5.3	5.3
Actuarial gain (loss) on scheme assets	4.4	(1.4)
Actual return on scheme assets	9.7	3.9
Gain (loss) due to change in assumptions	(6.3)	(23.1)
Experience gain (loss) on obligations	(1.8)	1.6
Actuarial gain (loss) on obligations	(8.1)	(21.5)

25 Current tax

The current tax liability of £7.4m (2011: liability £20.3m) represents the amount of income taxes repayable in respect of the current year plus a residual balance in respect of prior years.

26 Share capital

	Ordinary shares		Deferred shares	
In millions of shares	2012	2011	2012	2011
In issue at 1 January	68.1	68.1	3.0	3.0
In issue at 31 December	68.1	68.1	3.0	3.0

At 31 December 2012, the issued share capital comprised 68,108,975 ordinary shares (2011: 68,108,975) and 3,000,000 (2011: 3,000,000) deferred shares. The ordinary and deferred shares have a par value of £1 and were fully paid up at the beginning of the year.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. Deferred shares do not carry the right to vote and are not entitled to participate in profits of the Company. All shares rank equally with regard to the Company's residual assets, except that deferred shareholders participate only to the extent of the face value of the shares. On winding up, the deferred shares would rank second, repaying the holders the amount of capital paid up.

27 Operating leases

Leases as lessee

Non-cancellable operating lease rentals are payable as follows:

	2012 £m	2011 £m
Less than one year	2.3	2.8
Between one and five years	8.0	10.0
More than five years	4.8	6.7
Total	15.2	19.5

The Company leases office premises and warehouse storage under operating leases. The leases typically have an option to renew after the expiry date. Lease payments are increased every five years to reflect market rentals. None of the leases include contingent rentals.

During the year, £2.6m was recognised as an expense in the statement of comprehensive income in respect of operating leases (2011: £2.9m).

28 Staff numbers and costs

The total number of persons employed by the Company (including executive directors) at the year-end, analysed by category, was as follows:

	2012	2011
Business acquisition	685	627
Claims handling	934	908
Administration	360	366
	1,979	1,901

The full time equivalent number of employees was as follows:

	2012	2011
Business acquisition	637	588
Claims handling	837	811
Administration	338	340
	1,812	1,739

The average number of persons employed by the Company during the year was as follows:

	2012	2011
Total number of employees	1,939	1,787
Full time equivalent number of employees	1,785	1,643

The aggregate payroll costs in respect of these persons were as follows:

	2012 £m	2011 £m
Wages and salaries	47.9	43.9
Social security costs	4.3	4.1
Other pension costs	7.9	5.6
	60.1	53.6

29 Related party transactions

The Company has a related party relationship with its key management personnel who are all directors of the Company.

Transactions with directors

In addition to their salaries, the Company also provides non-cash benefits to directors and contributes to a post-employment defined benefit plan or a defined contribution scheme on their behalf. The directors' compensations are as follows:

	2012 £m	2011 £m
Short-term employee benefits	1.9	1.5
Post-employment benefits	0.3	0.3
Equity compensation benefits	0.1	0.1
	2.3	1.9

In respect of the highest paid director:

	2012	2011
Short-term employee benefits	0.5	0.5
Post-employment benefits	0.0	0.0
Equity compensation benefits	0.0	0.0
	0.5	0.5

Under the defined benefit scheme, the highest paid director's accrued pension at the year-end was £nil (2011: £nil).

The directors are able to obtain discounted personal insurance at the same rates as all other staff.

29 Related party transactions (continued)

In the ordinary course of business the Company carries out transactions with related parties as defined in IAS 24, Related Party Disclosures. Material transactions are set out below:

	2012 Comp. income	2012 Financial Position	2011 Comp. income	2011 Financial Position
	£m Income/ (expense)	£m Asset/ (liability)	£m Income/ (expense)	£m Asset/ (liability)
Immediate parent and ultimate holding company transactions and balances	(6.4)	(38.9)	2.4	-
Fellow subsidiary company transactions and balances	171.9	4.2	182.4	27.5
Subsidiary company transactions and balances	(1.6)	18.9	2.0	16.7
Pension scheme transactions and balances	(7.7)	13.2	(8.1)	10.7
Other related party transactions and balances	-	-	-	-
Grand total	156.2	(2.7)	178.7	54.9

The Company's immediate parent undertaking is Ageas (UK) Ltd which provides the Company with administration and management services.

Fellow subsidiary company transactions and assets relate to insurance policies sold by Ageas 50 Limited, UKAIS Ltd, Castle Cover Ltd and Kwik-Fit Insurance Services Ltd, insurance brokers which are wholly owned by Ageas (UK) Ltd.

The Company provides administration and claims settlement services to its fellow subsidiary, Ageas Services (UK) Ltd, in addition to loan facilities for which interest is charged.

The Company also bears the cost of rent charged by its subsidiary, Bishopsgate Head Office Ltd.

30 Capital commitments

	2012 £m	2011 £m
Authorised and contracted for	14.7	1.0
Authorised but not contracted for	-	-
	14.7	1.0

The balance relates to continued works on the premises purchased during the year.

31 Parent company

The Company's results are consolidated into the accounts of Ageas SA/NV a company incorporated in Belgium.

The ultimate holding company is Ageas SA/NV, incorporated in Belgium.

Copies of the above accounts can be obtained from the Company Secretary, Ageas Insurance Limited, Ageas House, Tollgate, Eastleigh, Hants SO53 3YA.

Ageas Insurance Limited

Statement of Directors' Responsibilities in respect of the Directors' Report and the Financial Statements

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

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with IFRSs as adopted by the EU and applicable law.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; 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 have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

Ageas Insurance Limited

Independent Auditor's Report to the Members of Ageas Insurance Limited

We have audited the financial statements of Ageas Insurance Limited for the year ended 31 December 2012 set out on pages 7 to 44. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 45, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's web-site at www.frc.org.uk/auditscopeukprivate.

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 for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the EU; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

Steve Liddell (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor

Chartered Accountants

Canary Wharf
15 Canada Square
London
E14 5GL

27 March 2013

Ageas Insurance Limited

Registered address
Ageas House, Tollgate, Eastleigh
Hampshire SO53 3YA

Registered in England and Wales No 354568

Ageas Insurance Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.