MIDDLESEA INSURANCE P.L.C.

A Member of the MAPFRE Group

Annual Report & Financial Statements 2011

Middlesea Insurance p.l.c.
A Member of the MAPFRE Group

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GROUP MISSION STATEMENT

We are committed to achieve sustainable growth to the benefit of our stakeholders by providing a comprehensive range of high quality insurance services to the communities where we operate and by fostering mutually beneficial relationships with all our customers.

BUSINESS PHILOSOPHY

We put our Customers first and strive to secure their loyalty through top quality service.

We value our Employees and seek to help them achieve their full potential.

We embrace Professionalism and seek Excellence in everything we do.

We do our best to help our Communities be better places in which to live, work and grow.

CHAIRMAN'S STATEMENT

This has been the second year of consolidation for Middlesea Insurance p.l.c. following the negative experience that the company went through in the Italian market in 2008 and 2009. The refocus on the Maltese market together with the restructuring of the Group has stabilised the Company and is now giving the desired results. The year also marked an important strategic development as MAPFRE Internacional, the global insurance operator, acquired majority control in the Company.

The satisfactory results registered during 2011 have to be considered against the background of an unprecedented financial and economic crisis on a European and International level, increased competition and moderate economic growth in our market.

The negative sentiment in investments both in Malta and globally, has had a negative downward pull on the final results which have however remained better than expected at the end of the year.

The major strategic event during 2011 was the acquisition by MAPFRE Internacional of the 19.9% shareholding owned by Munich Re on the 29th of July 2011, which was followed by the acquisition of an additional 3.58% shareholding from other shareholders following a Mandatory Offer in September 2011. Bank of Valletta p.l.c. decided to retain intact its' shareholding in the Company. The outcome of these regulatory approved transactions meant that MAPFRE Internacional has today 54.56% of the Company's shareholding and therefore majority interest in the Company. The balance is held by the other institutional shareholder Bank of Valletta p.l.c. (31.08%) and the other individual shareholders (14.36%).

As a result of MAPFRE Internacional taking control of the Company and a shareholders' agreement between Mapfre and Bank of Valletta p.l.c., Middlesea Insurance p.l.c. acquired a *de-facto* control over MSV Life p.l.c., in which Bank of Valletta p.l.c. holds 50 per cent of the shareholding.

Middlesea Insurance p.l.c. is now a subsidiary of MAPFRE Internacional, and forms part of MAPFRE's global operations. It benefits from the transfer of knowhow and expertise from one of the largest insurance groups worldwide with a presence in 46 countries, total equity of €9.8 billion, and premiums of €19.6 billion. MAPFRE Group registered a Net Profit after Tax of €963 million at the end of 2011.

It is in the best interest of all shareholders of the Company to form part of a global insurance company that contributes with its strong technical and commercial expertise in direct insurance besides providing accessibility to a portfolio of services that stretches the wide spectrum of insurance activities.

FINANCIAL RESULTS

The financial results for 2011 were satisfactory when considered in the context of the global and national economic situation. For the second year running, following the significant losses registered in 2008 and 2009, we registered profits and an increase in technical income from core operations. Due to the overall unfavourable capital market performance, we were adversely hit on the investment income side and that impacted our ability to reach the profit levels achieved in 2010. The audited financial statements for Middlesea Insurance p.l.c. show a profit before tax of €1.75 million in 2011 when compared to €8.86 million in 2010. The Middlesea Group reported a profit before tax of €3.11 million in comparison to €6.44 million recorded in the previous year. Our technical result on local operations before expenditure and investment income allocation improved from €4.3 million in 2010 to €6.5 million in 2011. Shareholders' equity in our balance sheet increased by 3% up from €54.1 million in 2010 to €55.7 million in 2011. Our solvency ratio has strengthened further achieving a level of 386% of the minimum regulatory requirement as at 31 December 2011 when compared to 359% in the previous year.

Our subsidiary BEE Insurance Management Ltd, which was subject to a thorough restructuring during 2010, registered a modest result and we are confident that a focused strategy to provide management services to third party insurance companies will improve the performance of this company. New companies were added to our list of clients during 2011, and during the first months of 2012, we are concluding new business with other international insurance companies.

MSV Life p.l.c. has registered a profit before tax of €5.43 million which is lower than the record level of €11.6 million achieved in 2010. Again this was mainly due to the impact of the financial markets. MSV Life p.l.c. remains the leading life insurer in Malta, with a customer base of over 80,000 policyholders, total assets of over €1.2 billion and shareholders' equity of over €112 million.

STRATEGY

Our strategy during 2011 was that for the second year running we continued with our consolidation of the fundamentals of Middlesea Insurance p.l.c. and group companies – first, by de-risking the Company from the perils of its ventures abroad, and second, by focusing on the market in which we have knowledge and experience, while improving on our market leadership position.

As we reported in a company announcement on 15 March 2011 and mentioned during our Annual General Meeting last year, Professor Avv. Andrea Gemma in his capacity as Liquidator appointed by ISVAP (the Italian insurance regulator), to oversee the administration of the Progress Assicurazioni S.p.A., filed for bankruptcy with the Italian courts in Palermo in February 2011. This is a normal procedure for the Liquidator to obtain a Court Ruling in order to move forward with the Liquidation process. There are no other developments for us to report on Progress since our last announcement.

In line with our stated policy, we have also as from the 1 January 2011 ceased underwriting business in Gibraltar and our operation there is in run-off.

Middlesea Insurance p.l.c. is now concentrating its activities only in Malta, gaining market share here while developing new products and improving on customer service.

We continued during the year with our organisational restructuring at various levels. At the top management level we have

CHAIRMAN'S STATEMENT

filled the previously vacant post of Chief Executive Officer with the appointment of Mr Alfredo Muñoz Perez as President & Chief Executive Officer. We have strengthened our top management team to streamline responsibilities, introduce new ideas, and reward talent with the appointment of Mr Christopher Borg as Vice President responsible for Corporate Services and Ms Anne Marie Tabone as Vice President responsible for Operations.

Following the extraordinary resolution taken during the Annual General Meeting of last year, the Balance Sheet was also restructured, to eliminate accumulated losses relating to the past and therefore to restore the Company's ability to declare dividends and share its profits with its shareholders.

As part of our product and business development, Middlesea Insurance p.l.c. entered into a joint venture with MAPFRE Assistencia during 2011 to set up a new independent company in Malta geared to introduce new concepts and services to the market which complement insurance products sold by the company. In line with this joint venture initiative, Middlesea Assist Ltd was incorporated and launched its operations in January 2012. Mapfre Assistencia holds 51 per cent in this new company, with the rest being owned by Middlesea Insurance p.l.c..

Other strategic priorities for 2012 include the remake of our corporate image to improve the brand value of the company and to reflect our current corporate reality. A new corporate brand will be launched in the coming weeks together with a new corporate website. We will continue investing in information technology as we position technology as a core business driver. A comprehensive programme of investment in our people is being given priority during 2012.

In line with our communitarian values and corporate social responsibility, we also kept our commitment to share our successes within reasonable parameters to support the needs of society. This took the form of sponsorships and initiatives directed at philanthropic organisations, art and cultural societies and in education. We are proud that after championing the establishment of the Insurance and Finance Degree at the University of Malta, Middlesea Insurance p.l.c. and MSV Life p.l.c. remain the only two committed entities that sustain graduate education in insurance in Malta and therefore contributing to open new opportunities to young people interested in a professional career in insurance.

DIVIDENDS

We have kept our promise to restore the company's dividend payment capabilities and to declare a dividend to our shareholders.

As explained during the last Annual General Meeting, the restructuring of our issued share capital and our profit and loss account last year within the parameters of the Companies Act, has restored our ability to declare a dividend following the profit registered during the year. The Board of Directors is declaring a total net dividend of €598,000 (2010 - €Nil), translating into a gross dividend payout of €920,000 for year 2011 which is equivalent to 53% of profit before tax for the year.

VISION AND OUTLOOK

The vision of my Board of Directors in transforming the Company remains valid in 2012 and will remain applicable in the coming years. I have been personally involved with Middlesea Insurance p.l.c. as a director in different roles since 1998, and I can objectively say that these last two years were critical in getting the Company back on track after the turbulence we faced in Italy. I found the full support of my fellow board members who must be commended for the time, attention and insight that they committed to the company to get us to where we stand today.

There is still more work to be done and the transformation process needs to be kept in pace and given priority by the Board of Directors, the President and CEO and his team. We are committed to a culture of change that is intended to improve the core of the business and achieve higher efficiencies. We must go on embracing change and our business priorities must continuously challenge the status quo which is always the biggest enemy of efficiency and growth. The transformation that started in 2010 must continue without hesitation and in strong force.

Our objective is to transform the Company into a lean, dynamically competitive and adaptable Company, that internally promotes meritocracy, empowers people and rewards talent, and which externally focuses on market leadership in innovation and business development. It is through transformational leadership and a confident and outward looking attitude that we can unleash the potential of our people and our customers to achieve the desired return to our shareholders.

A dual philosophy of ambitious goal setting and the embracement of change is necessary to further improve our business results. The Board of Directors has as its objective the enhancement of value added to its shareholders, the innovation of products and improvement of services to its customers, and the strengthening of the morale, competence and experience of its people.

CONCLUSION

It is with a sense of fulfilment that my chairmanship comes to an end following an eventful twenty-eight month tenure. I considered this position to be a transitional one having been called to lead the company during the most vulnerable period in its history and to steer it towards stability, security and renewed growth.

I thank all board members, management and employees of Middlesea Insurance p.l.c. who have contributed in different ways, and at times beyond the call of duty, over this period in order to restore the company to its traditional strength. My sincere gratitude also extends to our agents, brokers, tied insurance intermediaries and clients for their continued trust and custom, and to you, loyal shareholders for your support and for recognising the long term value of the company.

JOSEPH F.X. ZAHRA
CHAIRMAN
MIDDLESEA INSURANCE P.L.C.

28 FEBRUARY 2012

PRESIDENT & CHIEF EXECUTIVE OFFICER'S STATEMENT

Middlesea Insurance p.l.c. has registered satisfactory results for the financial year 2011 (FY 2011) notwithstanding the current economic situation. On the international scene, the economic slowdown and the financial markets crisis had immediate impact on the Company's results. The fierce competition and declining rates in the local insurance market made 2011 a challenging year to maintain and improve business profitability.

Total gross premiums for FY 2011 amounted to €31.8 million, 9% lower than FY 2010 volumes. The decrease is mainly attributed to the cessation of writing business in Gibraltar (8% of 2010 business volume, and nearly nil during this year), as well as to the decline in average premiums in most classes, significantly on motor policies, even though the number of individuals covered continue to grow. Nevertheless, earned net non-life premiums increased by 1% when compared to the previous year.

Rigorous claims management and underwriting measures that were put in place has led to a reduction in claims loss ratio in FY 2011; the financial statements point to a total reduction of 2% of claims ratio in gross terms, mainly as a result of a five point reduction in motor class, a very positive achievement considering the fierce price competition in the market. In net terms, the reduction seen is even larger, being close to six points, from 65.3% in 2010 to 59.5% to date.

All classes provided positive gross underwriting results, which is proof of a well balanced portfolio, combining corporate and retail policies generally retaining our market share in the main classes of business.

The technical account result for general business reached €2.42 million compared to €2.87 million in 2010. This reduction is attributable to a investment income of €0.79 million credited to the technical result compared to €1.67 million in the previous year. The long term business technical account balance also decreased due to lower investment returns by €0.1 million to €0.6 million in 2011. The technical performance of the Company for its general and life portfolio yielded a return of 11.2% on net earned premiums compared to 8.7% in 2010.

The investment income from the local capital markets reduced further in 2011 with losses being registered on the Company's local investment holdings, following further unwinding of previous years unrealized gain compared to gains booked in 2010.

Profits before tax reached €1.75 million compared to €8.86 million the year before. Whilst the technical results showed a marked improvement, the reduction was the result of a more contracted financial return and a significant decrease in Group dividends which amounted to €0.7 million compared to €6.8 million in the prior year. MSV Life p.l.c. did not distribute any dividends during the year, compared to €6.4 million in the previous year.

Middlesea Insurance p.l.c. continued to maintain a strong balance sheet. The consolidation of the company's financial structure has been a priority during 2011. Equity has been reinforced by the profit generated, whilst total financial debt has been reduced by 81%. Insurance and other receivables have decreased by 7% as a result of intensive collection efforts in a moment when liquidity and credit terms are of increasing concern across the market. Insurance and other payables have also been reduced considerably.

The solvency cover position of the Company as at December 2011 increased to 386% of the regulatory minimum requirement compared to 359% at the end of the previous year before view of Solvency II.

The reinsurance programme has always been a key tool for risk management for Middlesea Insurance p.l.c. and important in ensuring that results are sustainable and independent of cyclical adverse events. Outward reinsurance premiums amount to 43.1% of gross premiums, slightly lower than in the previous year due to favourable revised reinsurance contracts. The Company continues to purchase high level of protections, with risks being placed with top rated reinsurers in line with a strict reinsurance policy.

CONSOLIDATED FINANCIAL STATEMENTS 2011

The group statements include BEE Insurance Management Ltd. and other specialised subsidiaries, apart from the life specialist insurance company MSV Life p.l.c..

BEE Insurance Management Ltd. registered a modest performance during its first full year under the new brand, being totally focused on insurance management and back office services to third parties, and with a renovated management team, getting new contracts with international clients, increasing its presence in the insurance managers sector, and finally achieving the profit budgeted for 2011.

With Mapfre Internacional acquiring control over Middlesea Insurance p.l.c. as from 29 July 2011, Middlesea Insurance p.l.c. acquired *de-facto* control over MSV Life p.l.c. (MSV) and classified MSV as a subsidiary, thus consolidating fully the operation of MSV on a line by line basis. MSV's data significantly affects the basis of comparison with 2010, even though only a part of its activity has been recorded this year, and 2012 will be the first to show the entire dimension of the group. Full year premiums booked by MSV Life p.l.c. amounted to €126 million, and the year-end total assets reached €1.2 billion. The company is not only a top player because of its size, but also for its financial strength, with solvency cover at 171% of the minimum required by law, while investments were concentrated on high quality bond and equity issuers.

The consolidated technical account for long term business now includes €45 million of premium written by MSV Life p.l.c. over the last five months of 2011. The technical result in this class of business in the same period ammounted to €0.2 million.

The share of MSV Life p.l.c.'s profit after tax for the first seven months of the year is still shown in the non-technical account under "share of profit of associated undertaking", and amounts to €1.6 million. In 2010, the Group's share of MSV Life p.l.c.'s profit had reached €3.9 million for the twelve month period. The reduction was due to the current difficult market conditions that impinged on the investment return of the company.

OTHER ACHIEVEMENTS

The company has put in place diverse initiatives during the year 2011 in order to increase the range of services provided to customers and focused more on its distribution channels. The Company reinforced its governance structures and the way it operates drawing from Mapfre's experience in the global insurance market.

Past problems originating from our presence in foreign insurance markets are no longer on the daily agenda of managers and staff, who are now fully committed to the Maltese market. Following the cessation of writing business from our Gibraltar branch as from 1 January 2011, and the resulting slowdown in reported claims, intensive work has been undertaken to resolve outstanding claim files, a task that will continue next year. The Company continues to administer the run-off of past local legal and commercial cession reinsurance and international reinsurance portfolios. It is expected that closure of these portfolios should impact positively the results of the Company.

Since the third quarter of 2011, Middlesea Insurance p.l.c. has a new organization structure in place, designed to improve focus on the various operational aspects. Corporate Services staff are effectively supporting the business and a new Operations unit is boosting quality in customer services, approaching the market directly and through the distribution networks. A specific unit has been set up to administer aspects related to insurance intermediaries and to have front line resources exclusively focusing on business generation. Staff members are fully committed to ensuring that governance and control aspects are in line with the requirements for a regulated and listed company which is controlled by a group committed to achieving business objectives within the parameters of a strict code of conduct.

We must also emphasise on the importance of a new methodology under implementation for strategic planning for the Company within the Mapfre Group. A three year strategic plan defines short term and long term objectives with a number of critical projects involving a significant number of employees enriching their jobs and empowering them to attain clearly defined targets.

In order to provide a new range of services and products to Middlesea customers, Middlesea Insurance p.l.c. has entered into a joint venture with Mapfre Asistencia, the Mapfre Group entity which specialises in assistance services and special insurance lines, and which has an extensive presence in the five continents. Under this alliance, a new associate company, Middlesea Assist Limited, was incorporated late in 2011. Middlesea Insurance p.l.c. holds 49% shareholding while Mapfre Asistencia controls the other 51%. During the fourth quarter of the year, service structures were put in place, including a 24x7 call center, tow trucks, a service providers network and specialised computer systems. By the end of the year, the overall resources were in place for the start of operations, which were successfully launched during January 2012.

A branch has also been opened to service the Malta University campus with a range of new products oriented to the specific needs of the tertiary educational community. The corporate Head Office in Floriana has also been enhanced to offer a better service to our customers and our distribution channels.

Middlesea Insurance p.l.c. holds one of the most prestigious brands in the Maltese market and several initiatives have taken place to reinforce awareness of the brand *vis-à-vis* the general public, primarily by means of an increase in investment in media advertising and public relations.

In order to improve efficiency, major initiatives have kicked off in the area of IT services, ranging from new governance structures for the management of projects and external providers in the most efficient manner, to upgrades of several IT tools on the operational side, and the gathering of management information for direct and agency business. Current systems have been deployed across all distribution outlets to ensure operational efficiency and shared information.

Credit risk was also under focus, a critical factor towards getting an understanding of the potential impact of an economic slowdown on debt collection. Moreover, the Company has requested an external review of our reserving practices to ensure the accuracy and consistency of our claims reserves. Our accounting procedures have also been reviewed and enhanced to allow timely reporting schedules.

LOOKING FORWARD

In the short term, we believe that markets will continue to reflect tough competition in traditional lines, while economic uncertainties will restrict spending and risk appetite. However, in the mid-term the strength of the Maltese economy and the initiative of its citizens will provide new opportunities for the best performing insurance providers. A combination of internal expertise and international group experience and synergies will prove to be a strong formula for a growing and profitable company which will provide increasing returns to its shareholders.

Strong support from the major shareholders, one of the most solvent and diversified insurance organisations in the

PRESIDENT & CEO'S STATEMENT

world, and the leading financial institution in Malta, will be a key asset to ensure peace of mind to all Middlesea Insurance p.l.c. stakeholders including customers, intermediaries, providers and employees. A Board of Directors consisting of expert and prestigious members is also a key element for the supervision and assessment of the management team and a further guarantee to those who are involved in the Middlesea Insurance p.l.c. project.

To increase our portfolio we will offer current and new policyholders new products and added value services. Group support is one of the main assets to achieve this goal. Effective and increasing support to all distribution partners to increase their business size and margins, as well as customer satisfaction, will also be a key driver. The ability to get to all kinds of potential customers will be a priority, and from this perspective the web tools under development will be a major asset in order to make sure that our products will reach every social or age group in the islands.

The contribution of MSV Life p.l.c. will reinforce the group not only because of the expected financial return, but also because it is providing to the whole Maltese market a complete range of life insurance products, comprehensive of innovative savings and protection products.

Middlesea Insurance p.l.c. has as a main asset the quality, experience and commitment of a highly qualified workforce. Empowering staff, achieving effective delegation of duties and active participation in improvement plans will be a constant management priority for the coming years, accompanied by training programmes aimed at developing their skills. A number of steps towards meeting these objectives have already been met, as management is sharing experiences with worldwide colleagues at specialised meetings. From a personal perspective, leading this group of professionals is a privilege, a pleasure besides being a big responsibility.

On the corporate side new efforts will be undertaken to reinforce governance aspects and finalise the work required to meet the new and extensive legal requirements under the Solvency II rules. From a financial point of view, our company is well prepared for the new capitalisation requirements, based on its strong solvency and prudent accounting and reserving policies. We are also well on track to meet all requirements of an organisational nature arising from new rules, even when these will represent a major effort for insurance organisations across the European Union.

In this aspect, one of the major strengths of the company is the Internal Audit Department, a guarantee for the interest of shareholders and other related parties, independent from operational and executive lines, and which operates across the entire group, reporting directly to a Board Committee (the Audit Committee).

I must remark that our strategy will be oriented towards achieving sustainable growth and durable competitive advantages in the local market, with a prudent underwriting policy and rigorous administration, and with a view to the long term rather than immediate onetime gains.

We will also seek ways to help the Maltese society get a direct return from the company under the form of sponsorships and contributions to social programmes of common interest, something which has always been at heart to Middlesea Insurance p.l.c..

I believe that we can be optimistic for the future; this project will prove to be more and more attractive and those who trusted Middlesea Insurance p.l.c. will not regret it. The dividend proposed on 2011 results, even though it is a small amount, is a sign that the entity has started a new era, and after a period of consolidation and internal adjustments it has entered a new phase where we will increase our presence in Maltese homes and enterprises, providing a full set of insurance solutions for all their needs, and generating an equitable return to our shareholders.

ALFREDO MUÑOZ PEREZ
PRESIDENT & CHIEF EXECUTIVE OFFICER
MIDDLESEA INSURANCE P.L.C.

28 FEBRUARY 2012

BOARD OF DIRECTORS & COMPANY SECRETARY

CHAIRMAN
MR JOSEPH F. X. ZAHRA
B.A. (HONS) ECON., M.A. (ECON.), FCIM, MMRS – CHAIRMAN
NED I

FORMERLY: Head of Research Malta Development Corporation, Director Central Bank of Malta, Director Malta Development Corporation, Director Corinthia Hotels International Ltd, Chairman Bank of Valletta p.l.c., Chairman Middlesea Valletta Life Assurance Co. Ltd, Chairman Maltacom p.l.c., Chairman National Euro Changeover Committee, Chairman National Commission for Higher Education, and Chairman Malta Council for Culture and the Arts.

AT PRESENT: Chairman Middlesea Insurance p.l.c., Director Medserv p.l.c., Director Nemea Bank p.l.c., Director MSV Life p.l.c., Managing Director Market Intelligence Services Co. Ltd, Managing Director MISCO International Ltd, Chairman C. Fino & Sons Ltd, Chairman Document Archive Management Ltd, Chairman Impetus Europe Consulting Group Ltd, Chairman Multi Risk Limited, Chairman Multi Risk Indemnity Ltd, Director Multi Risk Benefits Ltd, Director PowerImage Services Ltd, (Cyprus), Director Promise Professional Services Ltd, (Cyprus), Director 3a Malta Ltd, Director Surge Consulting Ltd, Director Combined Maritime Services Ltd, Chairman BEE Insurance Management Ltd, Chairman EuroMed Risk Solutions Ltd, Chairman Euro Globe Holdings Ltd, Chairman Church Wharf Properties Ltd, Director Growth Investments Ltd, Director Foundation for Medical Services.

MR RODERICK E. D. CHALMERS
M.A. DIV.(EDIN), F.C.A., A.T.I.I., F.C.P.A., F.I.A.
NED

FORMERLY: A partner with the offices of Coopers and Lybrand (later PricewaterhouseCoopers) in Malta and in Hong Kong. Managing Partner Coopers & Lybrand Hong Kong and Chairman of the firm's South East Asia Regional Executive and a member of the International Board of Directors. Upon the merger of Coopers & Lybrand and Price Waterhouse in 1998, he was appointed Chairman, Asia-Pacific, for PricewaterhouseCoopers, until his retirement in 2000. He was also a member of the PwC Global Management Board. He served as a non-executive director of the Hong Kong Securities and Futures Commission and he was also a member of the Takeovers and Mergers Panel. He was appointed by the Financial Secretary of Hong Kong to sit on the Banking Advisory Committee.

AT PRESENT: Chairman Bank of Valletta Group, Chairman MSV Life p.l.c., Chairman Valletta Fund Management Ltd, Chairman Valletta Fund Services Ltd, Member of the Board of Gasan Group Ltd, Director Alfred Gera & Sons Ltd, Director Simonds Farsons Cisk p.l.c., Director Air Malta p.l.c., Director Global Sources Ltd, a NASDAQ listed company.

MR GASTON DEBONO GRECH
L.P. F.I.S.M.M. (LUTON), B.A. (LEG.), MAG.JUR. (INT. LAW) DIP. TRIB.ECCL. MELITA
NED I

FORMERLY: Director Malta Drydocks, Director Malta International Transport, Director Tug Malta, Director Smithtug Valletta. Served for 18 years as G.W.U. representative for the Security Department.

AT PRESENT: Legal Procurator.

MR TONIO DEPASQUALE
NED

FORMERLY: Chief Executive Officer Bank of Valletta Group p.l.c., General Manager Valletta Investment Bank Ltd, where he was responsible for the introduction of investment banking and other relative services within the BOV Group, Director Board of Bank of Valletta International Ltd, Chairman BOV Investments Ltd, Chairman BOV Stockbrokers Ltd, Chairman Malta Bankers' Association, Governor Finance Malta.

AT PRESENT: Director Valletta Fund Management Ltd, Director Valletta Fund Services Ltd, Director Valletta Cruise Port p.l.c., Director MSV Life p.l.c., Director BEE Insurance Management Ltd, Director Euromed Risk Solutions Ltd, Director La Valette Funds SICAV p.l.c., Director Wignacourt Funds SICAV p.l.c..

MR. JAVIER FERNÁNDEZ-CID PLAÑIOL
NED

FORMERLY: Holding a law degree from the Complutense University of Madrid. He has developed his career in the MAPFRE Group with different management positions in Spain and abroad and notably in Belgium and the US.

AT PRESENT: Chairman of MAPFRE INTERNACIONAL. Board member of the following MAPFRE Group companies: MAPFRE RE, MAPFRE ASISTENCIA, MAPFRE GLOBAL RISKS, MAPFRE USA, The Commerce Insurance Group (Massachusetts, USA) and MAPFRE INSULAR (The Philippines).

MR MARTIN GALEA
ACA (APPOINTED ON THE 27 FEBRUARY 2012)
NED I

FORMERLY: President of the Malta Federation of Industries, Vice President of the Malta Chamber of Commerce Enterprise and Industry, Member of the Malta Council of Economic and Social Development, President of Din L- Art Helwa, Member of the Malta Olympic Committee, Editor of the Malta Independent,

AT PRESENT: Managing Director of Joinwell Limited, Director of Printex Limited, President of The Malta Rugby Football Union, Chairman of the Malta Winemakers Association.

MR ANDRÈS JIMÈNEZ HÈRRADON
NED

FORMERLY: Mr A. Jimenez Hèrradon joined Mapfre organisation in 1966 and has held a number of senior management positions in insurance and reinsurance activities since 1982.

AT PRESENT: Mr Jimenez Hèrradon is 1st Vice-Chairman of MAPFRE S.A. and responsible for the international operations of the Group. He is a member of the Board and a member of the Executive Committee of Mapfre S.A., parent company of Mapfre Group, and member of the Board of trustees of FUNDACION MAPFRE.

MR PEDRO LÒPEZ SOLANES
ED

AT PRESENT: General Manager and Chief Financial Officer of Mapfre Internacional S.A. in Spain, Director of Mapfre Inversion Sociedad de Valores (Spain), Director Mapfre Global Risk (Spain), Chairman of Mapfre Genel Sigorta and Mapfre Genel Yasam (Turkey), Director of MSV Life p.l.c., (Malta), Director of Mapfre Re (Spain), Director of RMI Inc. (USA).

MR LINO SPITERI
K.O.M, M.A. (OXON.)
NED I

FORMERLY: Member of Parliament, Co-Chairman Malta-EU Joint Parliamentary Committee, Minister of Finance, Minister of Trade & Economic Development, Chairman Public Accounts Committee, Deputy Governor and Chairman Central Bank of Malta, Research Officer Malta Chamber of Commerce, Head of Publications Union Press, Editor Malta News, Executive Editor It-Torca, Chairman University Selection Board, Member Malta Broadcasting Authority, Director Progress Assicurazioni S.p.A.

AT PRESENT: Chairman Bortex Group, Vbie Group and P. Cutajar Ltd; sits on various other domestic boards and on boards of foreign financial institutions registered in Malta; columnist, The Times and Sunday Times of Malta.

THE NOBLE MR PAUL S. TESTAFERRATA MORONI VIANI
NED I

AT PRESENT: Mainly involved in tourism and investment services, market and sales research, contracting, administration, property construction and development, managing operations, strategic planning and new business development. Director of Bank of Valletta p.l.c., GO p.l.c., Innovate Software Limited, Mobisle Communications Limited, Worldwide Communications Limited, Go Data Centre Services Limited, St. George's Park Co. Ltd, SGP Projects Ltd, Euro Appliances Co. Ltd, Spinola Hotels Ltd, Reliant Ltd, Cambridge Place Ltd, Sales & Letting Ltd (formerly Circles Ltd) and Testaferrata Moroni Viani Holdings Ltd (formerly Macapps Ltd), Vltava Fund SICAV p.l.c., BMIT Limited, Bellnet Limited and BM Support Services Limited.

COMPANY SECRETARY
MR CARLO FARRUGIA,
DIP. GEN. MGMT (MAASTRICHT), PGDTI, M.A. (TRANSL. & INTERP.)

FORMERLY: Employed at the Central Bank of Malta and Malta Financial Services Authority and appointed as a bank inspector for a number of years.

AT PRESENT: Joined the Middlesea Group in 2007 and was appointed Company Secretary and Compliance Officer of the group companies. Serves as committee secretary to the Board Committees of Middlesea Insurance p.l.c.. Published the Dictionary for Financial Services and is involved in the Olympic Movement.

Dr Michael Sparberg resigned on the 29 July 2011 following the purchase by MAPFRE Internacional of the shareholding held by Munich Re.

NED – Non Executive Director
ED – Executive Director
I - Independent

HEAD OFFICES, BRANCHES & AGENCIES

HEAD OFFICES

MIDDLESEA INSURANCE P.L.C.
Middle Sea House
Floriana, FRN 1442
Tel: (00356) 2124 6262
Fax: (00356) 2124 8195
e-mail: middlesea@middlesea.com
website: www.middlesea.com

BRANCH

MIDDLESEA UNIVERSITY BRANCH
University of Malta
Msida
Tel: (00356) 2124 9812

LOCAL AGENCIES

ALLCARE INSURANCE
AGENCY LIMITED
University Roundabout
Msida
Tel: (00356) 2133 0011
Fax: (00356) 2134 7947
e-mail: info@allcare.com.mt

BONNICI INSURANCE
AGENCY LIMITED
222, The Strand
Gzira, GZR 1022
Tel: (00356) 2133 9110
Fax: (00356) 2131 0390
e-mail: info@bonniciinsurance.com

ENGLAND INSURANCE
AGENCY LIMITED
190, 1st Floor, Marina Street
Pieta, PTA 1904
Tel: (00356) 2125 1015
Fax: (00356) 2124 4507
e-mail: info@england.com.mt

LAFERLA INSURANCE
AGENCY LIMITED
Vincenti Buildings
Blk. 13, Flt. 18/19, Strait Street
Valletta, VLT 1453
Tel: (00356) 2122 4405
Fax: (00356) 2124 0811
e-mail: info@laferla.com.mt

MELITAUNIPOL INSURANCE AGENCY
LIMITED
17 Market Street
Floriana, FRN 1081
Tel: (00356) 2206 7000 / 2123 6363
Fax: (00356) 2124 1954
e-mail: agency@melitaunipol.com

GROUP FINANCIAL HIGHLIGHTS

	2011		2010	
	GBP'000	**US$'000**	GBP'000	US$'000
Gross premiums written:				
General Business	**25,432**	**39,395**	27,694	42,899
Life Business	**38,991**	**60,398**	1,585	2,455
Total gross premiums	**64,423**	**99,793**	29,279	45,354
Group investment income/(expense)	**5,303**	**8,215**	5,168	8,005
Profit for the financial year	**1,710**	**2,649**	4,470	6,924
Net Dividend proposed	**500**	**774**	-	-
Share Capital	**16,138**	**24,998**	**46,109**	**71,423**
Net technical reserves:				
General Business	**31,904**	**49,421**	33,135	51,326
Life Business	**864,503**	**1,339,136**	423	655
Shareholders'Funds	**47,207**	**73,125**	45,899	71,099
Net assets value per €0.21 share (2010 €0.60)	**0.51**	**0.79**	0.50	0.77
Total number of ordinary shares in issue	**92,000,000**	**92,000,000**	**92,000,000**	**92,000,000**

All figures have been translated at the rate of exchange ruling at 31 December 2011

	2011	2010
	€'000	€'000
Gross premiums written		
- General Business	**30,447**	33,155
- Life Business	**46,679**	1,897
General business results	**2,422**	2,870
Life business results	**843**	710
Investment return	**6,349**	6,187
Profit attributable to shareholders	**1,929**	5,351
Dividend proposed (net)	**598**	-
Earnings per share	**2.1c**	5.8c
Net asset value per share	**€0.61**	€0.60

PROFESSIONAL SERVICES

The Company and its subsidiaries, in addition to its regular staff complement, as at 31 December 2011 utilised the professional services of the following individuals and institutions:

LEGAL ADVISORS
Mamo TCV Advocates
Schriha, Attard Montalto, Galea & Associates

AUDITORS
PricewaterhouseCoopers

ACTUARIES
Towers Watson

BANKERS
Bank of Valletta p.l.c.
Lombard Bank (Malta) p.l.c.
HSBC Bank (Malta) Ltd
National Westminster Bank
SG Hambros Bank & Trust (Gibraltar) Limited
APS Bank Limited

SPONSORING STOCKBROKERS
Bank of Valletta p.l.c. - Financial Markets & Investments Division
Charts Investment Management Service Limited

GROUP COMMITTEES

THE INVESTMENT COMMITTEE
Mr Roderick E. D. Chalmers MA Div (Edin), FCA, ATII, FCPA, FIA
Mr Tonio Depasquale
Mr Pedro López Solanes
Mr Lino Spiteri K.O.M., MA (Oxon)

THE AUDIT COMMITTEE
Mr Lino Spiteri K.O.M., MA (Oxon) (Chairman)
Mr Roderick E. D. Chalmers MA Div (Edin), FCA, ATII, FCPA, FIA
Mr Pedro López Solanes
The Noble Mr Paul Testaferrata Moroni Viani

THE REMUNERATION COMMITTEE
Mr Tonio Depasquale
Dr Michael Sparberg (resigned on 29 July 2011)
Mr Javier Fernández-Cid Plañiol

THE COMPLIANCE & PREVENTION OF MONEY LAUNDERING AND RISK MANAGEMENT COMMITTEE
Mr Lino Spiteri K.O.M., MA (Oxon)
Mr Gaston Debono Grech L.P. FISMM (Luton), BA (Leg), Mag Jur. (Int. Law), Dip. Trib. Eccl. Melita
Mr Pedro López Solanes

The Company Secretary, Mr Carlo Farrugia, Dip.Gen.Mgmnt.(Maastricht), PGDTI, MA (Trans. and Interp.), acts as the committee secretary to the above mentioned committees.

DIRECTORS' REPORT

The directors present their report and the audited financial statements for the year ended 31 December 2011.

PRINCIPAL ACTIVITIES

The principal activities of the Group consist of the business of insurance. The Group is licensed to carry on general and long-term business. The Group is also authorised to provide investment services.

REVIEW OF BUSINESS

Middlesea Insurance p.l.c. registered a profit before tax of €1.75 million during the year ended 31 December 2011. Premium written by the stand-alone parent Company decreased by 9.2% over the 2010 volumes to €31.8 million, following the decision to cease writing business in Gibraltar as from the 1 January 2011.

The Group registered a profit before tax of €3.1 million for the year to 31 December 2011 (FY 2011) compared to a profit in FY 2010 of €6.4 million largely due to a more subdued performance of the Company's and Group's investment portfolio.

As detailed in note 33 to these financial statements, on 29 July 2011, Middlesea Insurance p.l.c. acquired *de-facto* control over MSV Life p.l.c. ("MSV"). MSV was previously recognised as an associated undertaking and on consolidation was accounted for using equity accounting and therefore, measured in the balance sheet at an amount that reflected the share of net assets in the associated undertaking. As from 29 July 2011, MSV was classified as a subsidiary and fully consolidated on a line by line basis. Income, expenses and other movements in reserves are reflected accordingly for the period between 29 July 2011 and 31 December 2011. The Group's share of profit of MSV prior to consolidation amounted to €1.6 million with post consolidation profit amounting to €0.2 million.

Middlesea Insurance p.l.c.'s solvency position as at 31 December 2011 stood at 386% of the minimum solvency requirement (2010: 359%).

Middlesea's Group capital and reserves attributable to shareholders' at 31 December 2011 amounted to €56.5 million (2010: €54.9 million) on a consolidated basis.

The directors expect that the present level of financial activity will be sustained in the foreseeable future within the Company and its subsidiaries. The Group has defined strategies for growth in the core business of each of the Group companies within the local market that are expected to continue strengthening the level of financial stability of the Group.

RESULTS AND DIVIDENDS

The consolidated profit and loss account is set out on page 32. A gross dividend in respect of year ended 31 December 2011 of €0.01 per share amounting to a total dividend of €920,000 (2010: €Nil) is to be proposed by the directors at the forthcoming annual general meeting. This is equivalent to a net dividend of €0.0065 per share amounting to a total net dividend of €598,000.

INFORMATION PURSUANT TO THE LISTING RULES

Pursuant to the Annual General Meeting held on the 3 May 2011, the shareholders approved the offsetting of the Company's accumulated losses partly through the reduction in the nominal value of each of its ordinary shares from a nominal value of €0.60 to €0.21, amounting to a reduction of the Issued Share Capital from €55,200,000 (divided into 92 million ordinary shares of €0.60 each) to €19,320,000 (divided into 92 million shares of €0.21 each).

In line with the aforesaid reduction the authorised share capital was reduced from €90,000,000 (divided into 150 million shares of €0.60 each) to €31,500,000 (divided into 150 million shares of €0.21 each).

SHAREHOLDERS HOLDING 5% OR MORE OF THE EQUITY SHARE CAPITAL AS AT 28 FEBRUARY 2012:

HSBC Bank Malta p.l.c. as subcustodian for BNY Brussels as custodian for Mapfre Internacional	54.56%
Bank of Valletta p.l.c.	31.08%

The Company has in place a document entitled 'Code of Dealing for Directors & Selected Officers and Employees' addressed to all directors and selected officers of the Company and its Subsidiary undertakings. The aim behind this Code is to ensure compliance with the Principles and the dealing rules including those contained in the Listing Rules. The Company has in place a system for recording all advance notices received in connection with permitted dealings by directors and selected officers and acknowledgements of such advance notices. Furthermore, the Company reminds all directors and senior officers of their obligation to conform to the Code of Dealing on a yearly basis.

DIRECTORS' REPORT

DIRECTORS

The directors of the Company who held office during the year and were re-appointed during the Annual General Meeting of the 3 May 2011 were:

Joseph F.X. Zahra
Roderick E. D. Chalmers
Gaston Debono Grech
Tonio Depasquale
Javier Fernández-Cid Plañiol
Andrés Jiménez Herradón
Michael Sparberg (resigned on the 29 July 2011)
Lino Spiteri
Paul Testaferrata Moroni Viani
Martin Galea (appointed 27 February 2012)

Pedro López Solanes was re-appointed as an executive director by the Board during the meeting held following the Annual General meeting of the 3 May 2011.

In accordance with the Articles of Association of the Company, all directors retire from office at the Annual General Meeting and are eligible for re-election or re-appointment. Further information is given in the Statement of Corporate Governance.

STATEMENT OF DIRECTORS' RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS

The directors are required by the Insurance Business Act, 1998 and the Maltese Companies Act, 1995 to prepare financial statements which give a true and fair view of the state of affairs of the Group and the parent Company as at the end of each reporting period and of the profit or loss for that period.

In preparing the financial statements, the directors are responsible for:

- ensuring that the financial statements have been drawn up in accordance with International Financial Reporting Standards as adopted by the EU;
- selecting and applying appropriate accounting policies;
- making accounting estimates that are reasonable in the circumstances;
- ensuring that the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Group and the parent Company will continue in business as a going concern.

The directors are also responsible for designing, implementing and maintaining internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and that comply with the Companies Act, 1995. They are also responsible for safeguarding the assets of the Group and the parent Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

DIRECTORS' REPORT

STATEMENT OF DIRECTORS' RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS - CONTINUED

The financial statements of Middlesea Insurance p.l.c. for the year ended 31 December 2011 are included in the Annual Report 2011, which is published in hard-copy printed form and may be made available on the parent company's website. The directors are responsible for the maintenance and integrity of the Annual Report on the website in view of their responsibility for the controls over, and the security of, the website. Access to information published on the company's website is available in other countries and jurisdictions, where legislation governing the preparation and dissemination of financial statements may differ from requirements or practice in Malta.

The directors confirm that, to the best of their knowledge:

- the consolidated financial statements give a true and fair view of the financial position of the Group and Company as at 31 December 2011, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union on the basis explained in note 1 to the financial statements; and
- the Annual Report includes a fair review of the development and performance of the business and the position of the Group and Company, together with a description of the principal risks and uncertainties that the Group and Company face.

AUDITORS

The auditors, PricewaterhouseCoopers, have indicated their willingness to continue in office and a resolution for their re-appointment will be proposed at the Annual General Meeting.

By order of the Board

JOSEPH F. X. ZAHRA
CHAIRMAN

ALFREDO MUÑOZ PEREZ
PRESIDENT & CHIEF EXECUTIVE OFFICER

MIDDLE SEA HOUSE
FLORIANA, MALTA

28 FEBRUARY 2012

CORPORATE GOVERNANCE – STATEMENT OF COMPLIANCE

1. INTRODUCTION

Issuers whose securities are listed on the Malta Stock Exchange are required to include in their Annual Financial Report a Corporate Governance Statement of Compliance (the 'Statement') providing, amongst others, an explanation of the extent to which they adopted the Code of Principles of Good Corporate Governance (the 'Code') contained in Appendix 5.1 of Chapter 5 of the current applicable Listing Rules of the Malta Financial Services Authority ('MFSA'). In terms of Listing Rule 5.94, Middlesea Insurance p.l.c. (the 'Company') is obliged to prepare a report explaining its compliance with the provisions of the Code. The Issuer's Auditors are to include a report on the Corporate Governance Statement of Compliance in the Annual Financial Report.

The Company notes that the Code does not prescribe mandatory rules but recommends principles so as to provide proper incentives for the Board of Directors (the 'Board') and the Company's management to pursue objectives that are in the interests of the Company and its shareholders. The Board strongly believes that by adopting the Code, the Company would benefit from more transparent governance structures and improved relations with the market with a view to enhancing market integrity and confidence.

Good corporate governance is the responsibility of the Board, and in this regard the Board has appointed a Task Force headed by the Chairman of the Board to carry out a review of the Company's compliance with the Code during the period under review. The Task Force has identified the requirements under the Code and has drafted an action plan for their implementation over a period of time. At the outset it is noted that some requirements under the Code have been determined as being too onerous on the Company to be implemented in the short to medium term.

As demonstrated by the information set out in this Statement and that contained in the Remuneration Report, the Company believes that it has, save as indicated herein in the section entitled 'Non-Compliance with Code' applied the principles and complied with the provisions of the Code throughout the accounting period under review. In the Non-Compliance Section, the Board indicates and explains the instances where it has departed from or where it has not applied the provisions of the Code, as allowed by the same Code.

2. COMPLIANCE WITH THE CODE

Principle 1 – The Board

The Board's role and responsibility is to provide the necessary leadership, to set strategy and to exercise good oversight and stewardship. As at the 31 December 2011 the Board was composed of a non-executive Chairman, seven non-executive Directors and one executive Director. Michael Sparberg, who was appointed by Munich Re at the Annual General Meeting held on the 3 May 2011, resigned as Director on the 29 July 2011 following the purchase by MAPFRE Internacional of the shareholding held by Munich Re. Mr. Martin Galea was appointed as non-executive director with effect from 27 February 2012.

During the Board meeting held on the 5 August 2011, the Board of Directors appointed Alfredo Muñoz Perez as President & Chief Executive Officer (CEO) of the Company. The Board is in regular contact with the CEO in order to ensure that the Board is in receipt of timely and appropriate information in relation to the business of the Company and management performance. This enables the Board to contribute effectively to the decision-making process, whilst at the same time exercising prudent and effective controls.

The Board delegates specific responsibilities to a number of committees, namely the Audit Committee, the Compliance, Prevention of Money Laundering and Risk Management Committee, the Investments Committee and the Remuneration Committee, each of which operates under formal terms of reference approved by the Board.

Further detail in relation to the Committees and the responsibilities of the Board is found in Principles 4 and 5 of this Statement.

Principle 2 – Chairman and CEO

The Chairman is responsible to lead the Board and to set its agenda. The Chairman ensures that the Board's discussions on any issue put before it go into adequate depth, that the opinions of all the Directors are taken into account, and that all the Board's decisions are supported by adequate and timely information. The Chairman ensures that the President & CEO develops a strategy which is agreed to by the Board. The Chairman of the Company is Joseph F.X. Zahra.

On the other hand, the CEO leads the Senior Management, whose main role and responsibilities are the execution of agreed strategy and managing the Company's business.

The Company's current organisational structure incorporates the position of a President & Chief Executive Officer, a position which is occupied by Alfredo Muñoz Perez who was appointed by the Board on the 5 August 2011.

CORPORATE GOVERNANCE – STATEMENT OF COMPLIANCE

2. COMPLIANCE WITH THE CODE - CONTINUED

Principle 2 – Chairman and CEO - continued

The positions of the Chairman of the Board and CEO are well defined with specific roles rendering these positions completely separate from one another.

Principle 3 – Composition of the Board

The Board considers that the size of the Board, whilst not being so large as to be unwieldy is appropriate, taking into account the size of the Company and its operations.

The combined and varied knowledge, experience and skills of the Board members provide a balance of competences that are required, and add value to the functioning of the Board and its direction to the Company.

As stated above, the Board is composed almost exclusively of non-executive Directors. Although not a Director, the President & CEO attends all Board meetings with a view to ensuring a full understanding and appreciation of the Board's policy and strategy and so that he can provide direct input to the Board's deliberations. In addition, certain members of Senior Management report to the Board as and when required.

The composition of the Board is determined by the Company's Articles of Association (which are in line with generally accepted practice in Malta). The appointment of Directors to the Board is reserved exclusively to the Company's shareholders, except in so far as an appointment may be made to fill a casual vacancy. All Directors are required to fulfil the fit and proper procedures carried out by the Malta Financial Services Authority in line with standard regulatory due diligence procedures.

During the period under review, the Board consisted of four independent Directors (including the Chairman) and five non-independent Directors in accordance with the Code.

In determining the independence or otherwise of its Directors, the Board considered, amongst others, the principles relating to independence of directors contained in the Code, the Company's own practice as well as general principles of good practice. The Board has taken the view that the length of service on the Board of two of its Board members, namely Lino Spiteri and Gaston Debono Grech, does not undermine the said Directors' ability to consider appropriately and independently the issues which are brought before the Board. Apart from possessing valuable experience and wide knowledge of the Company and its operations, the Board feels that the two Directors in question are able to exercise independent judgement and are free from any relationship which can hinder their objectivity.

Principle 4 – The Responsibilities of the Board

The Board acknowledges its statutory mandate to conduct the administration and management of the Company. The Board is fulfilling this mandate and discharging its duty of responsibility through the execution of the four basic principles of corporate governance namely, accountability, monitoring, strategy formulation and policy development.

The Board regularly reviews all the different aspects of the Company within the parameters of all relevant laws, regulations and codes of best practice, applies high ethical standards whilst taking into account stakeholders' interests, maintains an effective dialogue with all stakeholders, monitors the application of management policies and motivates Company Management.

BOARD COMMITTEES

The activities of the Board and of the Company's senior management team were monitored and supported by the Company's Committees that were structured to assist in specialist activities and governance issues. The said Board Committees are the Audit Committee, the Compliance, Prevention of Money Laundering and Risk Management Committee, the Investments Committee and the Remuneration Committee. The Terms of Reference of all the Board Committees have been approved by the Board of Directors and by the Malta Financial Services Authority.

AUDIT COMMITTEE

The Audit Committee's terms of reference are modelled mainly on the recommendations of the Cadbury Report and its principles, whilst also reflecting the provisions of the relative Listing Rules. The responsibilities of the Audit Committee include, the monitoring of the financial reporting process, the monitoring of the effectiveness of the Company's internal control, internal audit and risk management systems, the monitoring of the audit of the annual and consolidated accounts, the maintenance of communication on such matters between the Board, management, the external Auditors and the internal Auditors, the making of recommendations to the Board in relation to the appointment of the external Auditor and the approval of the remuneration and terms of engagement of the external Auditor following appointment by the Shareholders in general meeting, the monitoring and reviewing of the external Auditor's independence and in particular the provision

CORPORATE GOVERNANCE – STATEMENT OF COMPLIANCE

2. COMPLIANCE WITH THE CODE - CONTINUED

Principle 4 – The Responsibilities of the Board - continued

of additional services, the development and implementation of a policy on the engagement of the external Auditor to supply non-audit services, the reviewing of actuarial reports, the management of financial risks, the arm's length nature of related party transactions and the audit process. The terms and conditions of new contracts negotiated with related parties (regarding banking, reinsurance and agent related matters) are also reviewed by the Audit Committee.

The composition of the Company's Audit Committee is also regulated by the Listing Rules. In terms of Listing Rule 5.118, Lino Spiteri is the Director whom the Board considers as independent and competent in accounting/auditing due to his experience, knowledge and high profile appointments during his career which also included the financial services sector. Lino Spiteri has been a Director for more than twelve consecutive years. For the purposes of Listing Rule 5.119, such period is to be taken into consideration when determining the independence or otherwise of a director. The Board has taken the view that the length of service of Lino Spiteri does not undermine the said Director's ability to consider appropriately the issues which are brought before the Audit Committee. Apart from possessing valuable experience and wide knowledge of the Company and its operations, the Board feels that Lino Spiteri is able to exercise independent judgment and is free from any relationship which can hinder his objectivity.

The Audit Committee held six meetings during 2011. The Audit Committee members and relative attendance to meetings is listed below.

Lino Spiteri (Chairman)	6
Roderick E.D. Chalmers	6
Pedro López Solanes	5
Paul Testaferrata Moroni Viani	5

The Board Chairman, President & CEO, Vice President – Operations, Vice President – Corporate Services, Financial Controller, BEE General Manager and Internal Auditor attend the Audit Committee meetings by invitation. The external auditors are invited to attend specific meetings of the Audit Committee and are also entitled to convene a meeting of the committee if they consider that it is necessary. The Company Secretary also acts as Secretary to the Audit Committee.

Internal Audit is an independent appraisal function established within the Group to examine and evaluate its activities. The Internal Auditor reports to the Audit Committee and attends its meetings. The task assigned by the Audit Committee to the Internal Auditor is to adopt business process risk-based audits aimed at assessing the adequacy of controls and business process efficiency.

COMPLIANCE, PREVENTION OF MONEY LAUNDERING AND RISK MANAGEMENT COMMITTEE

This Committee assists the Board in overseeing the Group's compliance with the obligations imposed by legislation, codes, rules and regulations that are relevant to the Group and its business. This Committee is responsible for the proper implementation and review of the Group's risk policies and assessing the different types of risk to which the Group is exposed. It reports to the Board on the adequacy, or otherwise, of such policies. The respective Prevention of Money Laundering Reporting Officers of the Company and its Subsidiary also report directly to this Committee.

The Compliance, Prevention of Money Laundering and Risk Management Committee held five meetings during 2011. The Committee members and relative attendance to meetings is listed below.

Lino Spiteri (Chairman)	5
Gaston Debono Grech	4
Pedro López Solanes	3

The Board Chairman, President & CEO, Vice President – Operations, Vice President – Corporate Services, Financial Controller, BEE General Manager, Internal Auditor, Compliance Officers, Money Laundering Officer and Risk Officer attend the Committee meetings by invitation. The Company Secretary also acts as Secretary to the Committee.

INVESTMENTS COMMITTEE

The Investments Committee oversees the investment activities of the Company and its Subsidiaries, executes its policies and guidelines, scrutinises and approves material transactions and monitors results.

CORPORATE GOVERNANCE – STATEMENT OF COMPLIANCE

2. COMPLIANCE WITH THE CODE - CONTINUED

Principle 4 – The Responsibilities of the Board - continued

The Investments Committee held four meetings during 2011. The Committee members and relative attendance to meetings is listed below.

Roderick E.D. Chalmers (Chairman)	4
Tonio Depasquale	3
Pedro López Solanes	1
Lino Spiteri	4

The Board Chairman, President & CEO, Financial Controller and the Manager in charge of investments attend the Committee meetings by invitation. The Company Secretary also acts as Secretary to the Committee.

REMUNERATION COMMITTEE

The Board Chairman and the President & CEO attend the Committee meetings by invitation. The Company Secretary also acts as Secretary to the Committee.

The Remuneration Committee held three meetings during the period under review and the attendance to the meetings was the following:-

Tonio Depasquale (Chairman)	3
Javier Fernández-Cid	2
Michael Sparberg	2 (resigned on the 29 July 2011)

Principle 5 – Board Meetings

The activities of the Board of Directors are exercised in a manner designed to ensure that the Board effectively sets policies and supervises the operations of the Company. Management updates and provides the directors with a report at each Board Meeting, which sets out the Company's management accounts including key performance indicators since the date of the previous Board meeting. The report also provides a management commentary on the results and on relevant events and decisions and sets out background information on various subjects including any matter requiring the approval of the Board. Apart from setting the strategy and direction of the Company, the Board was actively involved in monitoring progress against budgets and plans and in approving material or significant transactions.

During the 2011 financial year, the Board of Directors of the Company held ten meetings. The attendance of Directors to the Board meetings is listed below.

Joseph F.X. Zahra (Chairman)	10
Roderick E.D. Chalmers	9
Gaston Debono Grech	9
Tonio Depasquale	7
Javier Fernández-Cid	9
Andrés Jiménez Herradón	1
Pedro López Solanes	7
Michael Sparberg	4 (out of 7 – resigned on the 29 July 2011)
Lino Spiteri	10
Paul Testaferrata Moroni Viani	9

The President & CEO attends the Board meetings by invitation.

Principle 6 – Information and Professional Development

The President & Chief Executive Officer (CEO) enjoys the full confidence of the Board. The CEO, although responsible for the recruitment and selection of senior management, consults with the Remuneration Committee and with the Board on the appointment of, and on the succession plan for senior management. Training (both internal and external) of management and employees is a priority and is implemented through the Human Resources Department.

Directors may, where they judge it necessary to discharge their duties as Directors, take independent professional advice on any matter at the Company's expense.

Directors have access to the advice and services of the Company Secretary, who is responsible for ensuring adherence to Board procedures as well as good information flows within the Board and its Committees.

CORPORATE GOVERNANCE – STATEMENT OF COMPLIANCE

2. COMPLIANCE WITH THE CODE - CONTINUED

Principle 6 – Information and Professional Development - continued

In December 2011 the Directors held a Directors' Forum to enable the Directors to be updated on current corporate governance requirements together with other statutory requirements emanating from law. In addition, the Company Secretary directs members of the Board to seminars or conferences which serve as professional development for Directors in the discharge of their functions on the Board and Committees.

Principle 7 – Evaluation of the Board's Performance

During the year under review, the Board undertook an evaluation of its own performance, the Chairman's performance and that of its Committees. The Board did not per se appoint a committee to carry out this performance evaluation, but the evaluation exercise was conducted through a Board Effectiveness Questionnaire prepared by the Company Secretary in liaison with the Chairman. The Chairman prepared a report following the replies submitted by the Directors and the said report was submitted to the Board. During 2012 the Board will be taking up the recommendations made in the report and evaluate any required action.

Principle 8 – Committees

The Company has opted not to set up a Nomination Committee. Further explanation is provided under the section entitled Non-Compliance with the Code of this Statement.

Principle 9 – Relations with Shareholders and with the Market

The Company recognises the importance of maintaining a dialogue with its shareholders and of keeping the market informed to ensure that its strategies and performance are well understood. The Board is of the view that during the period under review the Company has communicated effectively with the market through a number of company announcements and press releases.

The Company also communicates with its shareholders through the Company's Annual General Meeting (AGM) (further detail is provided under the section entitled General Meetings). The Chairman ensures that the necessary arrangements are in place so that the Chairmen of the respective Committees are present at the AGM to answer questions as and when required.

Apart from the AGM, the Company communicates with its shareholders through the Annual Report and Financial Statements, which are circulated to the shareholders on a yearly basis. The Company's website (www.middlesea.com) also contains information about the Company and its business, including the six-monthly financial statements and all issued company announcements.

The Company holds a meeting for stockbrokers and financial intermediaries before the publication of its annual financial statements.

The Chairman ensures that sufficient contact is maintained with major shareholders to understand issues and concerns.

Individual shareholders can raise matters relating to their shareholding and the business of the Company at any time throughout the year to the Office of the Company Secretary. Shareholders are also given the opportunity to ask questions at the AGM or submit written questions in advance. In terms of Article 52 of the Articles of Association of the Company and Article 129 of the Companies Act (Cap.386 of the Laws of Malta), the Board may call an extraordinary general meeting on the requisition of shareholders.

Principle 10 – Institutional Shareholders

Institutional shareholders keep the market updated on issues related to their company through company announcements and press releases. During the year under review, the Company has issued various press releases related to the controlling shareholder, namely MAPFRE Internacional in connection with the latter's operations abroad. The other institutional shareholder, namely Bank of Valletta p.l.c., is a listed company on the Malta Stock Exchange and consequently a steady flow of information is provided through company announcements and press releases. In addition the six monthly and yearly results normally include a section on the insurance interests of institutional shareholders.

Principle 11 – Conflicts of Interest

The Directors are strongly aware of their responsibility to act at all times in the interest of the Company and its shareholders as a whole and of their obligation to avoid conflicts of interest. During the period under review, the Board maintained its practice that when a potential conflict of interest may or is perceived to arise in respect of a Director in connection with any transaction or other matter, this interest is declared and the individual concerned refrains from taking part in proceedings or decisions relating to the matter. The Board minutes include a record of such declarations and of the action taken by the individual director concerned. As an exception to this rule, in order that the

CORPORATE GOVERNANCE – STATEMENT OF COMPLIANCE

2. COMPLIANCE WITH THE CODE - CONTINUED

Principle 11 – Conflicts of Interest - continued

directors may discharge their responsibilities efficiently and effectively, it was agreed that directors appointed by shareholders need not disclose a conflict of interest or potential conflict of interest where this arises due to a conflict or potential conflict between the Company and the shareholder who appointed such director. In such a case, directors are allowed to participate in the discussions provided that they are required to act honestly and in good faith and always in the best interest of the Company. The Code of Conduct launched in 2010 clearly sets out the Company's principles and direction on the management of conflicts of interest.

The Company has in place a document entitled 'Code of Dealing for Directors & Selected Officers and Employees' addressed to all directors and selected officers of the Company and its Subsidiary undertakings. The aim behind this Code is to ensure compliance with the Principles and the dealing rules including those contained in the Listing Rules. The Company has in place a system for recording all advance notices received in connection with permitted dealings by directors and selected officers and acknowledgements of such advance notices. Furthermore, the Company reminds all directors and senior officers of their obligation to conform to the Code of Dealing on a yearly basis.

Directors' interests in the share capital of the Company as at 31 December 2011 were as follows:

	Beneficial Interest	Non-Beneficial Interest
Gaston Debono Grech	50,916 shares	-
Joseph F.X. Zahra	1,214 shares	-

Paul Testaferrata Moroni Viani has an indirect shareholding, equivalent to 7,950 shares in the Company through his shareholding in other companies.

Principle 12 – Corporate Social Responsibility

The Company seeks to be an active player within the Community in which it operates and has a long history of addressing society's needs through business success, particularly in the fields of education and philanthropy. The Company was the pioneer in establishing professional Insurance studies in Malta, ensuring a platform and a continuous supply of trained professionals for the whole insurance market. The Company's commitment to education continued with its supporting the establishment of the first Insurance and Finance degree course at the University of Malta. In addition, during the year under review, the Company provided specific support in the fields of arts, culture and sports in the form of sponsorships and other activities. The Company seeks to put into practice good CSR principles on a daily basis with its own employees. The Company considers itself to be a good employer, encouraging open communication and personal development whilst creating opportunities based on performance, creativity and teamwork.

Internal Control and Risk Management System

This information is being provided in terms of Listing Rule 5.97.4

Authority to operate the Company is delegated to the President & CEO within the limits set by the Board. The Board is ultimately responsible for the Group's systems of internal control and for reviewing their effectiveness. Such systems are designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable as opposed to absolute assurance against material misstatement or loss. Through the Audit Committee and the Compliance, Prevention of Money Laundering and Risk Management Committee, the Board reviews the process and procedures to ensure the effectiveness of the Group's systems of internal control, which are monitored by the Internal Audit Department. The key features of the Group's systems of internal control are as follows:

Organisation - The Company also operates through the boards of directors of subsidiary and associated companies with clear reporting lines and delegation of powers. The Company's Chairman is also the Chairman of all the Company's subsidiaries, with the exception of MSV Life p.l.c. where he is a member of the board of directors.

Risk Identification - The management of each of the Group members is responsible for the identification and evaluation of key risks applicable to their areas of business. The Board reviews its risk management policies and strategies and oversees their implementation to ensure that identified key risks are properly assessed and managed.

Reporting - Functional, operating and financial reporting standards are applicable to all entities of the Group. Systems and procedures are in place to identify, control and to report on the major risks. The Board receives periodic management information giving comprehensive analysis of financial and business performance including variances against budgets.

CORPORATE GOVERNANCE – STATEMENT OF COMPLIANCE

2. COMPLIANCE WITH THE CODE - CONTINUED

General Meetings

This information is being provided in terms of Listing Rule 5.97.6.

Pursuant to the Company's statutory obligations in terms of the Companies Act and the MFSA Listing Rules, the Annual Report and Financial Statements, the declaration of a dividend, the election of directors, the appointment of the auditors, the authorisation of the directors to set their fees, and other special business, are proposed and approved at the Company's Annual General Meeting (AGM). The Board of Directors is responsible for developing the agenda for the AGM and sending it to the shareholders. The AGM is conducted in accordance with the Memorandum and Articles of the Company and has the powers therein defined. The Shareholders' rights can be exercised in accordance with the articles of association of the Company.

The Memorandum and Articles of the Company may be amended by means of an extraordinary resolution of the Company in general meetings.

All shareholders registered in the Shareholders' Register on the Record Date as defined in the Listing Rules, have the right to attend, participate and vote in the general meeting. A shareholder or shareholders holding not less than 5% in nominal value of all the shares entitled to vote at the general meeting may request the Company to include items on the agenda of a general meeting and/or table draft resolutions for items included in the agenda of a general meeting. Such requests are to be received by the Company at least forty six (46) days before the date set for the relative general meeting.

3. NON-COMPLIANCE WITH THE CODE

Principle 3 – Composition of the Board: Code Provision 3.2

The Board is composed almost entirely of non-executive Directors since it has eight non-executive Directors and one executive Director.

In terms of Code Provision 3.2.5 a Director is not deemed to be independent if he/she "has served on the Board for more than twelve consecutive years". The Board has taken the view that the length of service on the Board of two of its Board members, namely Lino Spiteri and Gaston Debono Grech, does not undermine the said Directors' ability to consider appropriately the issues which are brought before the Board. Apart from possessing valuable experience and wide knowledge of the Company and its operations, the Board feels that the two Directors in question are able to exercise independent judgment and are free from any relationship which can hinder their objectivity.

Principle 4 – The Responsibilities of the Board: Code Provision 4.2.7

This Code Provision recommends "the development of a succession policy for the future composition of the Board of Directors and particularly the executive component thereof, for which the Chairman should hold key responsibility".

In view of the fact that the appointment of Directors is (a) a matter reserved exclusively to the Company's shareholders (except where the need arises to fill a casual vacancy), (b) that every director retires from office at the Annual General Meeting, and (c) taking into account the Directors' non-executive role, the Company does not consider at this point in time the necessity to have in place a succession policy. However, the recommendation to have a policy will be kept under review.

Principle 6 – Information and Professional Development: Code Provision 6.1

This Code Provision recommends that "all new Directors should be offered a tailored induction programme on joining the Board which covers to the extent necessary to the Company's organisation and activities and his responsibilities as a Director".

On joining the Board, a new director is briefed by the Chairman on the background and workings of the Board of Directors. However a proper procedure for a tailored induction programme for new Directors is not currently in place.

Principle 7 – Evaluation of the Board's Performance: Code Provision 7.1

This Code Provision recommends that "the Board should appoint a committee chaired by a non-executive Director in order to carry out a performance evaluation of its role".

The Board has in place its standard evaluation exercise procedure through the compilation of the Board Effectiveness Questionnaire and the Board did not appoint a specific committee to carry out this performance evaluation which was delegated to the Chairman.

CORPORATE GOVERNANCE – STATEMENT OF COMPLIANCE

3. NON-COMPLIANCE WITH THE CODE - CONTINUED

Principle 8A – Remuneration Committee: Code Provision 8.A.1

This Code Provision recommends that "the Board of Directors should establish a Remuneration Comittee composed of non-executive Directors with no personal financial interest other than as shareholders in the Company, one of whom shall be independent and shall chair the Committee".

The Code clearly defines an independant non-executive Director under Principle 3. The Chairman of the Remuneration Committee, namely Tonio Depasquale, does not fall within the definition of independent non-executive Director in accordance with Principle 3 in view of his position with one of the Company's major shareholders. However the Board has taken the view that the position held by Tonio Depasquale with one of the major shareholders of the Company does not undermine the said Director's ability to consider appropriately the issues which are brought before the Remuneration Committee. Apart from possessing valuable experience and wide knowledge of the Company and its operations, the Board feels that Tonio Depasquale is able to exercise independent judgment and is free from any relationship which can hinder his objectivity.

Principle 8B – Nomination Committee

Pursuant to the Company's Articles of Association, the appointment of Directors to the Board is reserved exclusively to the Company's shareholders (in line also with general and commonly accepted practice in Malta). Shareholders with 11% or more of the shares in issue are entitled to appoint one director for every 11% holding, whilst the other shareholders are entitled to appoint the remaining Board members at the Annual General Meeting in accordance with the provisions of the Articles of Association.

Within this context, the Board believes that the setting up of a Nomination Committee is currently not required by the Company. The Company also considers that some of the functions of the Nomination Committee (particularly those relating to succession planning and the appointment of senior management) are already dealt with by the Remuneration Committee. Notwithstanding this, the Board will retain under review the issue relating to the setting up of a Nomination Committee.

Principle 9 – Relations with Shareholders and with the Market: Code Provision 9.3

Code Provision 9.3 requires the Company to have in place a mechanism to resolve conflicts between minority shareholders and controlling shareholders. This Code Provision has become applicable to the Company following the purchase by MAPFRE Internacional of Munich Re's shareholding during the last six months of 2011 whereby MAPFRE Internacional became a controlling shareholder.

This position by the Company will be kept under continous review and will be evaluated in the interest of all shareholders.

LINO SPITERI
DIRECTOR

JAVIER FERNANDEZ- CID
DIRECTOR

28 FEBRUARY 2012

REMUNERATION COMMITTEE'S REPORT TO THE SHAREHOLDERS

1. TERMS OF REFERENCE AND MEMBERSHIP

The Middlesea Insurance p.l.c. Group Remuneration Committee (the "Committee") hereby submits its report to shareholders in accordance with Section 8A of the Principles of Good Corporate Governance (Appendix 5.1 of the Listing Rules).

The Committee concentrates on recommending the remuneration policy for the directors and senior management, outlining the appropriate packages of their remuneration and monitoring the level and structure of remuneration of the non-executive directors on the basis of adequate information provided by Management.

During 2011, the Committee was composed of Tonio Depasquale (Chairman), Javier Fernández-Cid and Michael Sparberg (who resigned on the 29 July 2011 following the purchase by MAPFRE Internacional of the shareholding in the Company held by Munich Re). All the Committee members are independent non-executive directors. The Middlesea Insurance Chairman (Joseph F.X. Zahra), the President & CEO (Alfredo Muñoz Perez), and other members of senior management are invited to attend Committee meetings as and when required. The Company Secretary, Carlo Farrugia, acts as the Secretary to the Committee.

2. MEETINGS

The Remuneration Committee held three meetings during the period under review and the attendance to the meetings was the following:-

Member	Attended
Tonio Depasquale (Chairman)	3
Javier Fernández-Cid	2
Michael Sparberg	2 (resigned on the 29 July 2011)

The Committee determined and/or discussed the following matters:

- Remuneration Report
- Update on Collective Agreement developments
- Remuneration of Senior Executives
- Development of Performance appraisal system for employees
- Approval of a one-time discretionary bonus following MAPFRE's increased shareholding in Middlesea Insurance p.l.c.
- Recommendation for the maximum emoluments to Board Directors

3. REMUNERATION STATEMENT

3.1 REMUNERATION POLICY – SENIOR MANAGEMENT

The members of the Board determine the framework of the overall remuneration policy for Senior Management based on recommendations from the Committee. The Committee then establishes the individual remuneration arrangements of the Senior Management, namely the President & CEO, Vice Presidents, Company Secretary, Chief Officers, Financial Controller and Internal Auditor.

The Committee has access to independent external advice on remuneration matters as and when required.

The Committee considers that the current Senior Management remuneration packages are based upon the appropriate local market equivalents, and are fair and reasonable for the responsibilities involved. The Committee also believes that the remuneration packages are such as to enable the Company to attract, retain and motivate executives having the appropriate skills and qualities to ensure the proper management of the organisation.

There have been no significant changes in the Company's remuneration policy for Senior Management during the financial year under review and no significant changes are intended to be effected thereto in FY 2012. It is to be noted that during the last financial year, the Board appointed the President & CEO (this position was previously vacant). The positions for two Vice Presidents and a Financial Controller were filled by existing members of management. During 2012 the Board will also be considering a formal remuneration policy to be adopted by the Board of Directors on the recommendation of the Remuneration Committee which will include a performance appraisal system. The remuneration policy will deal with the remuneration of the President & CEO, Senior Management and all other staff members in accordance with good practice and after taking into consideration the local insurance and financial services environment to be able to benchmark accordingly.

The terms and conditions of employment of Senior Management are set out in their indefinite contracts of employment, where applicable. As a general rule, such contracts do not contain provisions for termination payments and other payments linked to early termination. Share options and profit sharing are not part of the Company's remuneration policy for Senior Management.

3. REMUNERATION STATEMENT – CONTINUED

3.1 REMUNERATION POLICY – SENIOR MANAGEMENT – CONTINUED

The President & CEO is eligible for an annual bonus entitlement by reference to the attainment of pre-established objectives and targets as recommended by the Remuneration Committee and approved by the Board.

The Senior Management is eligible for an annual salary increase within a maximum salary range approved by the Remuneration Committee. The said annual salary increase and bonus are not directly performance related. No supplementary pension or other pension benefits are payable to Senior Management.

In the case of the President & CEO, the Remuneration Committee is of the view that the linkage between fixed remuneration and performance bonus is reasonable and appropriate.

In the case of the Senior Management, there is no direct linkage between remuneration and performance since, as explained above, the annual salary increase are not directly performance related. However this system may change during 2012 due to the introduction of the performance appraisal system.

Non-cash benefits to which Senior Management are entitled are the use of a company car and health insurance. The death-in-service benefit also forms part of the non-cash benefits and the same terms are applicable to all other Company employees.

Total emoluments received by Senior Management during FY 2011 are reported hereunder in terms of Code Provisions 8.A.5.

3.2 REMUNERATION POLICY – DIRECTORS

As at the 31 December 2011, the Board of Directors of Middlesea Insurance p.l.c. was composed of eight non-executive directors and one executive director. Three Directors, namely Javier Fernández-Cid, Andrés Jiménez Herradón and Pedro López Solanes (the Executive Director), did not receive a fee in accordance with the established policy of the shareholder company, MAPFRE Internacional, with which they were employed and which appointed them. The maximum annual aggregate emoluments that may be paid to the Directors are approved by the shareholders in the General Meeting in terms of Article 81 of the Company's Articles of Association. This amount was fixed at an aggregate sum of €250,000 per annum at the thirtieth Annual General Meeting held on the 3 May 2011. The Company does not intend to make any changes to this maximum amount at the next Annual General Meeting to be held in 2012.

Based on the recommendations of the Committee, the current directors' fees as approved by the Board, which are similar to the previous year, are as follows:

Directors' Fees	In Euro
Chairman	40,000
Other Directors	12,000
Board Committees Fees	
Chairman	4,000
Members	3,000

None of the Company's directors have any service contracts with either the Company or any of its subsidiaries as at the end of the financial year.

Directors' emoluments are designed to reflect the time committed by Directors to the Company's affairs, including the different Board committees of which Directors are members, and their responsibilities on such committees. None of the Directors, in their capacity as a Director of the Company and/or Committee members, is entitled to profit sharing, share options, pension benefits or any other remuneration. Total emoluments received by Directors during FY 2011 are reported below in terms of Code Provisions 8.A.5.

3.3 CODE PROVISION 8.A.5

	Fixed Remuneration	Variable Remuneration	Share Options	Others
Emoluments of Senior Management:	€805,187	None	None	€55,107
Emoluments of Directors:	€139,750	None	None	None

REMUNERATION COMMITTEE'S REPORT TO THE SHAREHOLDERS

3. REMUNERATION STATEMENT – CONTINUED

3.3 CODE PROVISION 8.A.5 – CONTINUED

Fees payable to directors in respect of 2011 amounted in total to €139,750 (2010: €142,133) and were paid as directors' fees as follows:-

	Directors' Fees
Roderick E. D. Chalmers	€19,000
Gaston Debono Grech	€15,000
Tonio Depasquale	€19,000
Michael Sparberg	€8,750 (resigned on the 29 July 2011)
Lino Spiteri	€23,000
Paul Testaferrata Moroni Viani	€15,000
Joseph F. X. Zahra	€40,000

T. Depasquale

TONIO DEPASQUALE
CHAIRMAN
REMUNERATION COMMITTEE

28 FEBRUARY 2012

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Middlesea Insurance p.l.c.

REPORT ON THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011

We have audited the consolidated and stand-alone parent Company financial statements of Middlesea Insurance p.l.c. (together the "financial statements") on pages 30 to 115, which comprise the consolidated and parent Company balance sheets as at 31 December 2011, and the consolidated and parent Company profit and loss accounts, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

As explained more comprehensively in the Statement of Directors' responsibilities for the financial statements on pages 15 to 16, the directors are responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and the requirements of the Insurance Business Act, 1998 and the Maltese Companies Act, 1995, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion the financial statements

- give a true and fair view of the financial position of the Group and the stand-alone parent as at 31 December 2011, and of their financial performance and their cash flows for the year then ended in accordance with IFRSs as adopted by the EU; and
- have been properly prepared in accordance with the requirements of the Insurance Business Act, 1998 and the Maltese Companies Act, 1995.

REPORT ON CORPORATE GOVERNANCE

The Listing Rules issued by the Malta Listing Authority require the directors to prepare and include in their Annual Report a Statement of Compliance providing an explanation of the extent to which they have adopted the Code of Principles of Good Corporate Governance and the effective measures that they have taken to ensure compliance throughout the accounting period with those Principles.

The Listing Rules also require the auditor to include a report on the Statement of Compliance prepared by the directors.

We read the Statement of Compliance and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements included in the Annual Report. Our responsibilities do not extend to considering whether this statement is consistent with any other information included in the Annual Report.

We are not required to, and we do not, consider whether the Board's statements on internal control included in the Statement of Compliance cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

In our opinion, the Statement of Compliance set out on pages 17 to 24 has been properly prepared in accordance with the requirements of the Listing Rules issued by the Malta Listing Authority.

INDEPENDENT AUDITOR'S REPORT

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

We also have responsibilities:

- Under the Maltese Companies Act, 1995 to report to you if, in our opinion:
  - The information given in the directors' report is not consistent with the financial statements.
  - Adequate accounting records have not been kept, or that returns adequate for our audit have not been received from branches not visited by us.
  - The financial statements are not in agreement with the accounting records and returns.
  - We have not received all the information and explanations we require for our audit.
  - Certain disclosures of directors' remuneration specified by law are not made in the financial statements, giving the required particulars in our report.

- Under the Listing Rules to review the statement made by the directors that the business is a going concern together with supporting assumptions or qualifications as necessary.

We have nothing to report to you in respect of these responsibilities.

PricewaterhouseCoopers

167 MERCHANTS STREET
VALLETTA
MALTA

SIMON FLYNN
PARTNER

28 FEBRUARY 2012

PROFIT AND LOSS ACCOUNTS
TECHNICAL ACCOUNTS – GENERAL BUSINESS

		Year ended 31 December	
		Group and Company	
	Notes	**2011** **€'000**	2010 €'000
Earned premiums, net of reinsurance			
Gross premiums written	6	**30,447**	33,155
Outward reinsurance premiums		**(12,960)**	(14,699)
Net premiums written		**17,487**	18,456
Change in the gross provision for unearned premiums		**1,043**	(937)
Change in the provision for unearned premiums, reinsurers' share		**(204)**	635
		839	(302)
Earned premiums, net of reinsurance		**18,326**	18,154
Allocated investment return transferred from the non-technical account	8	**793**	1,667
Total technical income		**19,119**	19,821
Claims incurred, net of reinsurance			
Claims paid			
- gross amount		**16,544**	18,036
- reinsurers' share		**(4,996)**	(5,336)
		11,548	12,700
Change in the provision for claims			
- gross amount		**426**	(71)
- reinsurers' share		**(1,060)**	(780)
		(634)	(851)
Claims incurred, net of reinsurance		**10,914**	11,849
Net operating expenses	7	**5,783**	5,102
Total technical charges		**16,697**	16,951
Balance on the technical accounts for general business (page 32)		**2,422**	2,870

PROFIT AND LOSS ACCOUNTS
TECHNICAL ACCOUNTS – LONG TERM BUSINESS

		Year ended 31 December			
		Group		Company	
	Notes	**2011 €'000**	2010 €'000	**2011 €'000**	2010 €'000
Earned premiums, net of reinsurance					
Gross premiums written	6	**46,679**	1,897	**1,380**	1,897
Outward reinsurance premiums		**(2,119)**	(864)	**(769)**	(864)
Earned premiums, net of reinsurance		**44,560**	1,033	**611**	1,033
Investment income					
Income from investments	8	**3,791**	253	**128**	253
Other technical income, net of reinsurance	9	**269**	-	**-**	-
Total technical income		**48,620**	1,286	**739**	1,286
Claims incurred, net of reinsurance					
Claims paid					
- gross amount		**29,638**	603	**395**	603
- reinsurers' share		**(579)**	(407)	**(152)**	(407)
		29,059	196	**243**	196
Change in the provision for claims					
- gross amount		**(819)**	1	**(57)**	1
- reinsurers' share		**303**	21	**9**	21
		(516)	22	**(48)**	22
Claims incurred, net of reinsurance		**28,543**	218	**195**	218
Change in other technical provisions, net of reinsurance					
Long term business provision, net of reinsurance					
- gross amount		**2,207**	274	**(44)**	274
- reinsurers' share		**2,669**	(170)	**(4)**	(170)
		4,876	104	**(48)**	104
Investments contracts with DPF – gross		**10,517**	-	**-**	-
		15,393	104	**(48)**	104
Net operating expenses	7	**3,841**	254	**(19)**	254
Total technical charges		**47,777**	576	**128**	576
Balance on the technical account for long term business (page 32)		**843**	710	**611**	710

PROFIT AND LOSS ACCOUNTS
NON-TECHNICAL ACCOUNTS

		Year ended 31 December			
		Group		Company	
	Notes	**2011 €'000**	2010 €'000	**2011 €'000**	2010 €'000
Balances on technical accounts					
General business (page 30)		**2,422**	2,870	**2,422**	2,870
Long term business (page 31)		**843**	710	**611**	710
		3,265	3,580	**3,033**	3,580
Share of profit of associated undertaking	8	**1,644**	3,920	**-**	-
Total income from insurance activities		**4,909**	7,500	**3,033**	3,580
Other investment income	8	**2,037**	3,035	**2,247**	9,530
Investment expenses and charges	8	**(1,123)**	(1,021)	**(966)**	(1,021)
Allocated investment return transferred to the general business technical account	8	**(793)**	(1,667)	**(793)**	(1,667)
Other income	9	**856**	1,252	**-**	-
Administrative expenses	7	**(2,776)**	(2,658)	**(1,767)**	(1,565)
Profit for the financial year before tax		**3,110**	6,441	**1,754**	8,857
Tax expense	12	**(1,063)**	(1,090)	**(711)**	(1,118)
Profit for the financial year		**2,047**	5,351	**1,043**	7,739
Attributable to:					
- shareholders		**1,929**	5,351	**1,043**	7,739
- non-controlling interests		**118**	-	**-**	-
		2,047	5,351	**1,043**	7,739
Earnings per share attributable to shareholders	14	**2.1c**	5.8c		

The Notes on pages 40 to 115 are an integral part of these financial statements.

STATEMENTS OF COMPREHENSIVE INCOME

		Year ended 31 December			
		Group		Company	
	Notes	**2011 €'000**	2010 €'000	**2011 €'000**	2010 €'000
Profit for the financial year		**2,047**	5,351	**1,043**	7,739
Other comprehensive income:					
Fair value gain on investment in associated undertakings	28	**-**	-	**529**	2,016
Change in other available-for-sale investments	28	**20**	31	**23**	-
Share of increase in value of in-force business of subsidiary undertaking	16	**1,434**	-	**-**	-
Share of (decrease)/increase in value of in-force business of associated undertaking	28	**(1,100)**	903	**-**	-
Total other comprehensive income, net of tax		**354**	934	**552**	2,016
Total comprehensive income for the year		**2,401**	6,285	**1,595**	9,755

Attributable to:		
- shareholders	**1,566**	6,285
- non-controlling interests	**835**	-
Total comprehensive income for the year	**2,401**	6,285

Items disclosed in the statement above are disclosed net of tax. The income tax relating to each component is disclosed in Notes 22 and 28.

The Notes on pages 40 to 115 are an integral part of these financial statements.

BALANCE SHEETS

		At 31 December			
		Group		Company	
		2011	2010	**2011**	2010
	Notes	**€'000**	€'000	**€'000**	€'000
ASSETS					
Intangible assets	16	**44,725**	468	**498**	457
Property, plant and equipment	17	**4,787**	1,874	**1,579**	1,393
Investment property	18	**66,537**	7,406	**8,111**	7,831
Investment in subsidiary undertakings	19	**-**	-	**57,214**	1,212
Investment in associated undertakings	20	**5,208**	53,009	**147**	55,473
Other investments	21	**1,056,563**	40,976	**25,634**	40,348
Deferred income tax	22	**2,351**	2,620	**1,113**	1,113
Reinsurers' share of technical provisions	23	**16,436**	15,357	**16,208**	15,357
Deferred acquisition costs	24	**2,898**	2,960	**2,898**	2,960
Insurance and other receivables	25	**21,835**	10,303	**9,306**	10,056
Income tax receivable		**4,725**	331	**416**	290
Cash and cash equivalents	26	**7,380**	2,734	**952**	1,875
Total assets		**1,233,445**	138,038	**124,076**	138,365
EQUITY					
Capital and reserves attributable to shareholders					
Share capital	27	**19,320**	55,200	**19,320**	55,200
Share premium account		**688**	2,221	**688**	2,221
Other reserves	28	**20,939**	21,302	**34,686**	34,134
Profit and loss account		**15,568**	(23,774)	**1,043**	(37,413)
		56,515	54,949	**55,737**	54,142
Non-controlling interests		**55,825**	-	**-**	-
Total equity		**112,340**	54,949	**55,737**	54,142
LIABILITIES					
Deferred income tax	22	**8,200**	766	**927**	748
Provisions for other liabilities and charges	29	**1,199**	833	**1,199**	833
Technical provisions:					
- Insurance contracts and investment contracts with DPF	23	**1,029,254**	55,531	**54,813**	55,531
- Investment contracts without DPF	23	**60,338**	-	**-**	-
Derivative financial instruments	21	**189**	-	**-**	-
Borrowings	30	**8,500**	13,285	**2,500**	13,285
Insurance and other payables	31	**13,425**	12,674	**8,900**	13,826
Total liabilities		**1,121,105**	83,089	**68,339**	84,223
Total equity and liabilities		**1,233,445**	138,038	**124,076**	138,365

The Notes on pages 40 to 115 are an integral part of these financial statements.

The financial statements on pages 30 to 115 were authorised for issue by the Board on 28 February 2012 and were signed on its behalf by:

JOSEPH F. X. ZAHRA
CHAIRMAN

ALFREDO MUÑOZ PEREZ
PRESIDENT & CHIEF EXECUTIVE OFFICER

STATEMENTS OF CHANGES IN EQUITY

Group

		Attributable to shareholders				
	Notes	**Share capital** €'000	**Share premium account** €'000	**Other reserves** €'000	**Profit & loss account** €'000	**Total** €'000
Balance at 1 January 2010		55,200	2,221	20,368	(29,125)	48,664
Comprehensive income						
Profit for the financial year		-	-	-	5,351	5,351
Other comprehensive income:						
Change in other available-for-sale investments	28	-	-	31	-	31
Share of increase in value of in-force business of associated undertaking	28	-	-	903	-	903
Total other comprehensive income, net of tax		-	-	934	-	934
Total comprehensive income		-	-	934	5,351	6,285
Balance at 31 December 2010		**55,200**	**2,221**	**21,302**	**(23,774)**	**54,949**

STATEMENTS OF CHANGES IN EQUITY

Group - continued

	Notes	Share capital €'000	Share premium account €'000	Other reserves €'000	Profit & loss account €'000	Total €'000	Non-controlling interests €'000	Total €'000
		Attributable to shareholders						
Balance at 1 January 2011		55,200	2,221	21,302	(23,774)	54,949	-	54,949
Comprehensive income								
Profit for the financial year		-	-	-	1,929	1,929	118	2,047
Other comprehensive income:								
Change in other available-for-sale investments	28	-	-	20	-	20	-	20
Share of increase in value of in-force business of subsidiary undertaking	28	-	-	717	-	717	717	1,434
Share of increase in value of in-force business of associated undertaking	28	-	-	(1,100)	-	(1,100)	-	(1,100)
Total other comprehensive income, net of tax		-	-	(363)	-	(363)	717	354
Total comprehensive income		-	-	(363)	1,929	1,566	835	2,401
Transactions with owners								
Reduction of capital against accumulated losses	27	(35,880)	(1,533)	-	37,413	-	-	-
Non-controlling interest arising on business combination	33	-	-	-	-	-	54,990	54,990
Total transactions with owners		(35,880)	(1,533)	-	37,413	-	54,990	54,990
Balance at 31 December 2011		**19,320**	**688**	**20,939**	**15,568**	**56,515**	**55,825**	**112,340**

STATEMENTS OF CHANGES IN EQUITY

Company

	Notes	**Share capital** €'000	**Share premium account** €'000	**Other reserves** €'000	**Profit & loss account** €'000	**Total** €'000
Balance at 1 January 2010		55,200	2,221	32,118	(45,152)	44,387
Comprehensive income						
Profit for the financial year		-	-	-	7,739	7,739
Other comprehensive income:						
Fair value gain on investment in associated undertaking	28	-	-	2,016	-	2,016
Total other comprehensive income, net of tax		-	-	2,016	-	2,016
Total comprehensive income		-	-	2,016	7,739	9,755
Balance at 31 December 2010		**55,200**	**2,221**	**34,134**	**(37,413)**	**54,142**

STATEMENTS OF CHANGES IN EQUITY

Company - continued

	Notes	Share capital €'000	Share premium account €'000	Other reserves €'000	Profit & loss account €'000	Total €'000
Balance at 1 January 2011		55,200	2,221	34,134	(37,413)	54,142
Comprehensive income						
Profit for the financial year		-	-	-	1,043	1,043
Other comprehensive income:						
Change in other available-for-sale investment	28	-	-	23	-	23
Fair value gain on investment in associated undertaking	28	-	-	529	-	529
Total other comprehensive income, net of tax		-	-	552	-	552
Total comprehensive income		-	-	552	1,043	1,595
Transactions with owners						
Reduction of capital against accumulated losses	27	(35,880)	(1,533)	-	37,413	-
Total transactions with owners of the company, recognised directly in equity		(35,880)	(1,533)	-	37,413	-
Balance at 31 December 2011		**19,320**	**688**	**34,686**	**1,043**	**55,737**

The Notes on pages 40 to 115 are an integral part of these financial statements.

STATEMENTS OF CASH FLOWS

		Year ended 31 December			
		Group		Company	
	Notes	**2011 €'000**	2010 €'000	**2011 €'000**	2010 €'000
Cash flows from operating activities					
Cash generated from/(used in) operations	32	**5,178**	3,016	**(4,145)**	(915)
Dividends received		**1,468**	286	**879**	5,579
Interest received		**12,669**	1,010	**1,199**	982
Interest paid		**(576)**	(753)	**(576)**	(753)
Income tax paid		**(1,055)**	(562)	**(617)**	(1,496)
Net cash generated from/(used in) operating activities		**17,684**	2,997	**(3,260)**	3,397
Cash flows from investing activities					
Purchase of investment property	18	**(85)**	(241)	**(21)**	(241)
Disposal of investment property		**-**	2,357	**-**	2,357
Increase in investment in associated undertaking		**(147)**	-	**(147)**	-
Purchase of financial investments	21	**(209,000)**	(32,888)	**(27,788)**	(32,888)
Disposal of financial investments	21	**193,428**	38,776	**41,621**	38,528
Purchase of property, plant and equipment and intangible assets	16,17	**(893)**	(713)	**(543)**	(872)
Disposal of property, plant and equipment and intangible assets	16,17	**115**	222	**-**	14
Net cash (used in)/generated from investing activities		**(16,582)**	7,513	**13,122**	6,898
Cash flows from financing activities					
Bank loans	30	**(10,785)**	(3,000)	**(10,785)**	(3,000)
Subordinated loan		**-**	(8,500)	**-**	(8,500)
Net cash used in financing activities		**(10,785)**	(11,500)	**(10,785)**	(11,500)
Net movement in cash and cash equivalents		**(9,683)**	(990)	**(923)**	(1,205)
Cash and cash equivalents at beginning of year		**2,734**	3,724	**1,875**	3,080
Recognition of subsidiary undertakings	33	**14,329**	-	**-**	-
Cash and cash equivalents at end of year	26	**7,380**	2,734	**952**	1,875

The Notes on pages 40 to 115 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. BASIS OF PREPARATION

These financial statements are prepared in accordance with International Financial Reporting Standards as adopted for use in the European Union, the Insurance Business Act, 1998 and the Maltese Companies Act, 1995.

The financial statements are prepared under the historical cost convention as modified by the revaluation of property, plant and equipment, investment property, investment in associated undertaking, financial assets and financial liabilities at fair value through profit or loss, available-for-sale investments and the value of in-force business.

The preparation of financial statements in conformity with the above reporting framework requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 3.

The balance sheet is organised in increasing order of liquidity, with additional disclosures on the current or non-current nature of the Group's assets and liabilities provided within the Notes to the financial statements. All amounts in the Notes are shown in thousands of euro, rounded to the nearest thousand, unless otherwise stated.

On 29 July 2011, Middlesea Insurance p.l.c. acquired *de-facto* control over MSV Life p.l.c. ("MSV"). MSV was previously recognised as an associated undertaking and on consolidation was accounted for using equity accounting and therefore, measured in the balance sheet at an amount that reflected the share of net assets in the associated undertaking. As further explained in Note 33, as from 29 July 2011, MSV was classified as a subsidiary and fully consolidated on a line by line basis. Income, expenses and other movements in reserves are reflected accordingly for the period between 29 July 2011 and 31 December 2011.

Standards, interpretations and amendments to published standards effective in 2011

In 2011, the Group adopted new standards, amendments and interpretations to existing standards that are mandatory for the Group's accounting period beginning on 1 January 2011. The adoption of these revisions to the requirements of IFRSs as adopted by the EU did not result in substantial changes to the Group's accounting policies.

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

Certain new standards, amendments and interpretations to existing standards have been published by the date of authorisation for issue of these financial statements but are mandatory for the Group's accounting periods beginning after 1 January 2011. The Group has not early adopted these revisions to the requirements of IFRSs as adopted by the EU and the Group's directors are of the opinion that, with the exception of IFRS 9 'Financial Instruments', there are no requirements that will have a possible significant impact on the Group's financial statements in the period of initial application.

IFRS 9, 'Financial Instruments', addresses the classification and measurement of financial assets, and replaces the multiple classification and measurement models in IAS 39 with a single model that has only two classification categories: amortised cost and fair value. Classification under IFRS 9 is driven by the reporting entity's business model for managing the financial assets and the contractual characteristics of the financial assets. IFRS 9, 'Financial Instruments', also addresses the classification and measurement of financial liabilities, and retains the majority of the requirements in IAS 39 in relation to financial liabilities. Subject to adoption by the EU, IFRS 9 is effective for financial periods beginning on, or after, 1 January 2015. The Group is considering the implications of the standard and its impact on the Group's financial results and position, together with the timing of its adoption taking cognisance of the endorsement process by the European Commission.

2. OTHER ACCOUNTING POLICIES

The principal other accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 CONSOLIDATION

(a) Subsidiary undertakings

The consolidated financial statements incorporate the assets, liabilities and results of the Company and its subsidiary (or group) undertakings drawn up to 31 December each year. Subsidiary undertakings are those companies over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. The Group also assesses existence of control where

NOTES TO THE FINANCIAL STATEMENTS

2. OTHER ACCOUNTING POLICIES - CONTINUED

2.1 CONSOLIDATION - CONTINUED

(a) Subsidiary undertakings - continued

it does not have more that 50% of the voting power but is able to govern the financial and operating polices by virtue of *de-facto* control. *De-facto* control may arise in circumstances where the size of the Group's voting rights relative to the size and dispersion of holdings of other shareholders give the Group the power to govern the financial and operating policies, etc.

Subsidiaries are fully consolidated from the date on which effective control is transferred to the Group.

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The Group recognises any non-controlling interest in the acquiree on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognised amounts of acquiree's identifiable net assets.

Acquisition-related costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is re-measured to fair value at the acquisition date through profit or loss.

Any contingent consideration to be transferred by the Group is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognised in accordance with IAS 39 either in profit or loss or as a change to other comprehensive income. Contingent consideration that is classified as equity is not re-measured, and its subsequent settlement is accounted for within equity.

Goodwill is initially measured as the excess of the aggregate of the consideration transferred and the fair value of non-controlling interest over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in profit or loss.

Inter-company transactions, balances, income and expenses on transactions between group companies are eliminated. Profits and losses resulting from inter-company transactions that are recognised in assets are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the group. A list of the Group's subsidiaries is set out in Note 19.

(b) Associated undertakings

Associated undertakings are entities over which the Group has significant influence, generally accompanying a shareholding of between 20% and 50% of the voting rights, but which it does not control. Except for investment-linked insurance funds, interests in associated undertakings are accounted for by the equity method of accounting and are initially recognised at cost and the carrying amount is increased or decreased to recognise the investor's share of profit or loss of the investee after the date of acquisition.

The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition. Equity accounting involves recognising in the profit and loss the share of the associated undertaking's post-acquisition profits or losses and recognising in reserves its share of post-acquisition movements in reserves. The interest in the associated undertaking is carried in the balance sheet at an amount that reflects the share of the net assets of the associated undertaking. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Intra-group gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Intra-group losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies for associated undertakings are changed where necessary to ensure consistency with the policies adopted by the Group. A list of the Group's associated undertakings is set out in Note 20.

NOTES TO THE FINANCIAL STATEMENTS

2. OTHER ACCOUNTING POLICIES - CONTINUED

2.1 CONSOLIDATION - CONTINUED

(b) *Associated undertakings* - continued

Interests in associated undertakings that are allocated to the insurance fund are designated as financial assets at fair value through profit or loss. They are accounted for in accordance with the recognition and measurement principles described in Note 2.9.

2.2 SEGMENT REPORTING

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, responsible for allocating resources and assessing performance of the operating segments, has been identified as the executive management which implements the strategic decisions taken by the Board. In identifying the Group's business segments, the chief operating decision-maker is also guided by the Regulations under the Insurance Business Act, 1998 on the disclosure requirements relevant to specified insurance classes of business.

2.3 FOREIGN CURRENCY TRANSLATION

Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The euro is the Group and Company's functional and presentation currency.

Transactions and balances

Transactions in foreign currencies have been converted into the functional currency at the rates of exchange ruling on the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the profit and loss account.

All foreign exchange gains and losses that relate to net claims incurred are presented in the technical profit and loss account within 'claims incurred'. All other foreign exchange gains and losses are presented in the profit and loss account within 'investment income' or 'investment expense'.

Translation differences on financial assets and liabilities held at fair value through profit and loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as other available-for-sale financial assets, are included in the fair value reserve in other comprehensive income.

2.4 INTANGIBLE ASSETS

Value of in-force business

The value of in-force business is determined by the directors after considering the advice of the Group's Approved Actuary. The valuation represents the discounted value of projected future transfers to shareholders from contracts in force at the year end, after making a provision for taxation. In determining this valuation, assumptions relating to future mortality, persistence and levels of expenses are based on experience of the type of business concerned.

Gross investment returns and asset allocations assumed vary depending upon the mix of investments held by the Company and expected market conditions. Annual movements in the value of the in-force business are credited or debited to reserves.

Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised using the straight-line method over their useful lives, not exceeding a period of five years. All costs associated with maintaining computer software programmes are recognised as an expense as incurred.

NOTES TO THE FINANCIAL STATEMENTS

2. OTHER ACCOUNTING POLICIES - CONTINUED

2.4 INTANGIBLE ASSETS - CONTINUED

Deferred policy acquisition costs – long term contracts

Incremental costs that are incurred in acquiring new investment contracts without DPF are capitalised as deferred acquisition costs (DAC). The DAC is subsequently amortised over the life of the contracts as follows:

- For long term investment contracts with a fixed maturity date, DAC is amortised over the life of the contract.
- For long term investment contracts with no fixed date of maturity, DAC is amortised over the estimated useful life of the contract. This basis is reviewed periodically with reference to the historical experience of surrenders for these contracts.

2.5 PROPERTY, PLANT AND EQUIPMENT

All property, plant and equipment is initially recorded at historical cost. Freehold land and buildings, are shown at fair value based on periodic valuations by external independent valuers, less subsequent depreciation for buildings. Valuations are carried out on a regular basis such that the carrying amount of property does not differ materially from that which would be determined using fair values at the end of the reporting period. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset, and the net amount is restated to the re-valued amount of the asset. All other property, plant and equipment is stated at historical cost less depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the profit and loss account during the financial period in which they are incurred.

Increases in the carrying amount arising on revaluation of land and buildings are credited to other reserves in shareholders' equity. Decreases that offset previous increases of the same asset are charged against other reserves directly in equity; all other decreases are charged to the profit and loss account. Each year the difference between depreciation based on the revalued carrying amount of the asset charged to the profit and loss account and depreciation based on the asset's original cost is transferred from 'other reserves' to 'retained earnings'.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives as follows:

Buildings	100 years
Leasehold improvements	40 years
Motor vehicles	5 years
Furniture, fittings and equipment	3 - 10 years

The assets' residual values and useful lives are reviewed at the end of each reporting period and adjusted if appropriate.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (accounting policy 2.11).

Gains and losses on disposals are determined by comparing proceeds with carrying amounts and are included in the profit and loss account. When revalued amounts are sold, the amounts included in the revaluation reserve relating to the assets are transferred to retained earnings.

2.6 INVESTMENT PROPERTY

Property held for long-term rental yields that is not occupied by the companies in the Group is classified as investment property.

Freehold and leasehold properties treated as investment property principally comprise office and other commercial buildings that are held for long term rental yields and that are not occupied by the Group. Investment property is carried at fair value. Fair value is based on active market prices, adjusted, if necessary for any difference in the nature, location or condition of the specific asset. If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices in less active markets. These valuations are reviewed annually by an independent valuation expert. Investment property that is being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value. Changes in fair values are reported in the profit and loss account.

NOTES TO THE FINANCIAL STATEMENTS

2. OTHER ACCOUNTING POLICIES - CONTINUED

2.6 INVESTMENT PROPERTY - CONTINUED

If an investment property becomes owner-occupied, it is reclassified as property, plant and equipment, and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes.

2.7 INVESTMENTS IN GROUP UNDERTAKINGS

In the Company's financial statements, investments in group undertakings are accounted for by the cost method of accounting less impairment.

Provisions are recorded, where, in the opinion of the directors, there is an impairment in value. Where there has been an impairment in the value of an investment, it is recognised as an expense in the period in which the impairment is identified. If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the profit and loss account.

The dividend income from such investments is included in the profit and loss account in the accounting year in which the Company's rights to receive payment of any dividend is established.

On disposal of an investment, the difference between the net disposal proceeds and the carrying amount is charged or credited to the profit and loss account and included within investment income.

2.8 INVESTMENTS IN ASSOCIATED UNDERTAKINGS

In the Company's financial statements, investments in associated undertakings are accounted at fair value. Changes in the fair value of associated undertakings are recognised in other comprehensive income. Fair value is determined by using valuation techniques that are commonly accepted such as the present value technique, and other valuation techniques.

When investments are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the profit and loss account. Dividends are recognised in the profit and loss account when the Company's right to receive payments is established. Both are included within investment income.

2.9 FINANCIAL ASSETS

The Group classifies its financial assets into the following categories: financial assets at fair value through profit or loss, other available-for-sale investments and loans and receivables. The classification is dependant on the purpose for which the investments were acquired. The directors determine the appropriate classification of investments at the time of purchase and re-evaluate such designation at every reporting date.

Classification

- Financial assets at fair value through profit or loss are part of a group of investments that is managed on a portfolio basis and whose performance is evaluated and reported internally on a fair value basis to the Group's Board and relevant key management personnel in accordance with a documented investment strategy. Assets that are part of these portfolios are designated upon initial recognition at fair value through profit or loss. Financial assets that are held to match insurance and investment contracts liabilities are also designated at inception as fair value through profit or loss to eliminate the accounting mismatch that would otherwise arise from measuring insurance assets or liabilities, or recognising the gains and losses on them on different bases. Derivatives are also classified as fair value through profit or loss.

- Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that the Group has designated as fair value through profit or loss. They include, *inter alia*, insurance and other receivables, income tax receivable, cash and cash equivalents in the balance sheet as well as other financial investments (comprising deposits with credit institutions, unlisted fixed income debt securities and treasury bills) classified as loans and receivables within Note 21.

- Other available-for-sale investments (i.e. available-for-sale investments other than the investment in associated undertakings) are those non-derivative financial assets that are designated as available-for-sale or are not classified as (a) loans and receivables, (b) held-to-maturity or (c) financial assets at fair value through profit or loss. They include *inter alia* unlisted equities.

NOTES TO THE FINANCIAL STATEMENTS

2. OTHER ACCOUNTING POLICIES - CONTINUED

2.9 FINANCIAL ASSETS - CONTINUED

Recognition and measurement

All purchases and sales of investments are recognised on the trade date, which is the date that the Group commits to purchase or sell the assets. All investments are initially recognised at fair value plus, in the case of all financial assets not carried at fair value through profit or loss, transaction costs that are directly attributable to their acquisition. Financial assets are de-recognised when the rights to receive cash flows from them have expired or where they have been transferred and the Group has also transferred substantially all risks and rewards of ownership.

Financial assets at fair value through profit or loss and other available-for-sale investments are subsequently re-measured at fair value. Loans and receivables are carried at amortised cost using the effective interest method, less any provision for impairment.

Gains or losses arising from changes in the value of the 'financial assets at fair value through profit or loss' category are presented in the profit and loss account in the period in which they arise.

Changes in the fair value of monetary and non-monetary securities classified as available-for-sale are recognised in other comprehensive income. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in other comprehensive income are included in the profit and loss account within investment income.

For financial instruments traded in active markets, the determination of fair values of financial assets and financial liabilities is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes. The quoted market price used for financial assets held by the group is the current bid price. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the market for a financial asset is not active, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same and discounted cash flow analysis.

Derivatives are recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices and other valuation techniques, as appropriate. Subsequent changes in the fair value of any derivative instruments are recognised immediately in the profit and loss account. All derivatives are carried as assets when fair value is positive, and as liabilities when fair value is negative.

The Group enters into currency forward contracts to hedge the foreign exchange risk arising on its investments denominated in a foreign currency. These transactions provide effective economic hedges under the Group's risk management policies. However hedge accounting under the specific rules in IAS 39 is not required because the change in the value of the hedged financial instrument is recognised in the profit and loss account.

2.10 IMPAIRMENT OF ASSETS

(a) Impairment of financial assets at amortised cost

The Group assesses at each end of the reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset ("a loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

NOTES TO THE FINANCIAL STATEMENTS

2. OTHER ACCOUNTING POLICIES - CONTINUED

2.10 IMPAIRMENT OF ASSETS - CONTINUED

(a) Impairment of financial assets at amortised cost - continued

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group about the following events:

(i) significant financial difficulty of the issuer or debtor;
(ii) a breach of contract, such as a default or delinquency in payments;
(iii) it becoming probable that the issuer or debtor will enter bankruptcy or other financial reorganisation;
(iv) the disappearance of an active market for that financial asset because of financial difficulties; or
(v) observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the Group.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred on loans and receivables carried at amortised cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the profit and loss account.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the profit and loss account.

(b) Assets classified as investments in associated undertakings/other available-for-sale investments

The Group assesses at end of the reporting period whether there is objective evidence that an available-for-sale financial asset is impaired, including in the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and current fair value, less any impairment loss on the financial asset previously recognised in the profit or loss – is removed from equity and recognised in the profit and loss account. Impairment losses recognised in the profit and loss account on equity instruments are not subsequently reversed through the profit and loss account.

(c) Impairment of other non-financial assets

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

2.11 OFFSETTING FINANCIAL INSTRUMENTS

Financial assets and liabilities are offset and the net amount reported in the consolidated balance sheet only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

NOTES TO THE FINANCIAL STATEMENTS

2. OTHER ACCOUNTING POLICIES - CONTINUED

2.12 CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash in hand and deposits held at call with banks, which are held for operational purposes.

2.13 SHARE CAPITAL

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

Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction from the share premium.

2.14 INSURANCE AND INVESTMENT CONTRACTS

The Group issues contracts that transfer insurance risk or financial risk or both.

(a) Classification

Insurance contracts are those contracts that transfer significant insurance risk. Such contracts may also transfer financial risk. As a general guideline, the Group defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event that are at least 10% more than the benefits payable if the insured event did not occur.

Investment contracts are those contracts that transfer financial risk with no significant insurance risk.

A number of insurance and investment contracts contain a discretionary participation feature (DPF). This feature entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses:

- that are likely to be a significant portion of the total contractual benefits;
- whose amount or timing is contractually at the discretion of the Group; and
- that are based on realised and/or unrealised investment returns on underlying assets held by the Group.

Local statutory regulations and the terms and conditions of these contracts set out the bases for the determination of the amounts on which the additional discretionary benefits are based (the DPF eligible surplus), and within which the Group may exercise its discretion as to the quantum and timing of their payment to contract holders, also considering the advice of the Approved Actuary.

(b) Recognition and measurement

Insurance contracts and investment contracts with DPF are classified into five main categories depending on the duration of risk and whether or not the terms and conditions are fixed.

(i) Short-term insurance contracts - General business

The results for general business are determined on an annual basis whereby the incurred cost of claims, commission and related expenses are charged against the earned proportion of premiums, net of reinsurance as follows:

- Premiums written comprise all amounts due during the financial year in respect of contracts of insurance entered into regardless of the fact that such amounts may relate in whole or in part to a later financial year and includes any differences between the booked premiums for prior years and those previously accrued, less cancellations.

- Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date, calculated on a time apportionment basis.

- Commissions and other acquisition costs that vary with, and are related to, securing new contracts and renewing existing contracts are deferred over the period in which the related premiums are earned. These are capitalised and shown as deferred acquisition costs ("DAC") in the balance sheet. DAC is amortised over the term of the policies as the premium is earned. All other costs are recognised as expenses when incurred.

- Claims incurred comprise claims and related expenses paid in the year and changes in the provisions for outstanding claims and related expenses, together with any other adjustments to claims from previous years. Where applicable, deductions are made for salvage and other recoveries.

NOTES TO THE FINANCIAL STATEMENTS

2. OTHER ACCOUNTING POLICIES - CONTINUED

2.14 INSURANCE AND INVESTMENT CONTRACTS - CONTINUED

(b) Recognition and measurement - continued

(i) Short-term insurance contracts - General business - continued

- Provision is made at the year-end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the Group. The estimated cost of claims includes expenses to be incurred in settling claims. The Group takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. The Group does not discount its liabilities for unpaid claims. Liabilities for unpaid claims are estimated using the input of assessments for individual cases reported to the Group and statistical analysis for the claims incurred but not reported, and to estimate the expected ultimate cost of more complex claims that may be affected by external factors (such as court decisions).

- Provision in the form of an unexpired risk provision, is made on the basis of claims and administrative expenses likely to arise after the end of the financial year from contracts concluded before the balance sheet date, in so far as their estimated value exceeds the provision for unearned premiums and any premiums receivable under those contracts.

(ii) Group Life insurance contracts

Group life business (classified as long-term insurance business under the Insurance Business Act, 1998) consists of annual policies that cover the lives of a group of customers' employees for the year under cover. Premiums, including reinsurance premiums, and claims are accounted for when due for payment. Reinsurance recoveries are accounted for in the same period as the related claim. The long-term business provision is based on the net "unearned premiums" method as adjusted to take into account the premium written. The valuation is carried out in conjunction with the Company's appointed independent actuary. Profits, which accrue as a result of actuarial valuations, are released to the non-technical profit and loss account. Any shortfall between actuarial valuations and the balance on the long-term business provision is appropriated from the non-technical profit and loss account.

(iii) Long term insurance contracts – life and annuity

These contracts insure events associated with human life (for example death or survival) over a long and fixed duration. The guaranteed and fixed element for these contracts relates to the sum assured, i.e. the benefit payable on death or maturity.

Premiums are recognised as revenue when they become payable by the contract holder. Premiums are shown before deduction of commission, and are inclusive of policy fees receivable.

Maturity claims are charged against revenue when due for payment. Surrenders are accounted for when paid or, if earlier, on the date when the policy ceases to be included within the calculation of the liability. Death claims are accounted for when notified. Claims payable include related claims handling costs.

A liability for contractual benefits that are expected to be incurred in the future is recorded when the premiums are recognised. For traditional life insurance contracts, the liability is calculated on the basis of a prudent prospective actuarial method, using assumptions regarding mortality, maintenance expenses and investment income, and includes a margin for adverse deviations. Additionally, liabilities under unit-linked life insurance contracts reflect the value of assets held within unitised investment pools. The liability is recalculated at each balance sheet date. It is determined by the Group's Approved Actuary following his annual investigation of the financial condition of the Group's long term business as required under the Insurance Business Act, 1998. The above method of calculation satisfies the minimum liability adequacy test required by IFRS 4.

(iv) Long term insurance contracts with DPF

These contracts further combine a DPF that entitles the holder to receive a bonus as declared by the Group from the DPF eligible surplus.

Premiums are recognised as revenue when they become payable by the contract holder. Premiums are shown before deduction of commission, and are inclusive of policy fees receivable.

Maturity claims are charged against revenue when due for payment. Surrenders are accounted for when paid or, if earlier, on the date when the policy ceases to be included within the calculation of the liability. Death claims are accounted for when notified. Claims payable include related claims handling costs.

NOTES TO THE FINANCIAL STATEMENTS

2. OTHER ACCOUNTING POLICIES - CONTINUED

2.14 INSURANCE AND INVESTMENT CONTRACTS - CONTINUED

(b) Recognition and measurement - continued

(iv) Long term insurance contracts with DPF - continued

Bonuses charged to the long term business technical account in a given year comprise:

(i) new reversionary bonuses declared in respect of that year, which are provided within the calculation of the respective liability;
(ii) terminal bonuses paid out to policyholders on maturity and included within claims paid;
(iii) terminal bonuses declared at the Group's discretion and included within the respective liability.

A liability for contractual benefits that are expected to be incurred in the future is recorded when the premiums are recognised. The liability is determined as the sum of the expected discounted value of the future cash flows based on bonuses consistent with the bonus policy and prudent rates of future investment return, expenses and mortality, and includes margins for adverse deviations. The liability is recalculated at each balance sheet date. The liability is determined by the Group's Approved Actuary following his annual investigation of the financial condition of the Group's long term business as required under the Insurance Business Act, 1998. The above method of calculation satisfies the liability adequacy test required by IFRS 4.

(v) Investment contracts with DPF

These contracts do not expose the Group to significant insurance risk. They contain a DPF that entitles the holder to receive a bonus as declared by the Group from the DPF eligible surplus.

Recognition and measurement principles are the same as for insurance contracts with DPF as described above. Additionally, liabilities under unit-linked life insurance contracts reflect the value of assets held within unitised investment pools.

(c) Reinsurance contracts held

Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on one or more contracts issued by the Group and that meet the classification requirements for insurance contracts are classified as reinsurance contracts held. Insurance contracts entered into by the Group under which the contract holder is another insurer (inwards reinsurance) are included with insurance contracts.

The benefits to which the Group is entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers (classified within receivables), as well as longer term receivables (classified within reinsurers' share of technical provisions) that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

The Group assesses its reinsurance assets for impairment on a regular basis. If there is objective evidence that the reinsurance asset is impaired, the Group reduces the carrying amount of the reinsurance asset to its recoverable amount and recognises that impairment loss in the profit and loss account. The Group gathers the objective evidence that a reinsurance asset is impaired using the same process adopted for financial assets held at amortised cost. The impairment loss is also calculated following the same method used for these financial assets. These processes are described in accounting policy 2.10.

(d) Receivables and payables related to insurance contracts

Receivables and payables are recognised when due. These include amounts due to and from agents, brokers and insurance contract holders.

If there is objective evidence that an insurance receivable is impaired, the Group reduces the carrying amount of the insurance receivable accordingly and recognises that impairment loss in the profit and loss account. The Group gathers the objective evidence that an insurance receivable is impaired using the same process adopted for financial assets held at amortised cost.

The impairment loss is calculated following the same method used for these financial assets. These processes are described in accounting policy 2.10.

NOTES TO THE FINANCIAL STATEMENTS

2. OTHER ACCOUNTING POLICIES - CONTINUED

2.14 INSURANCE AND INVESTMENT CONTRACTS - CONTINUED

(e) Liability adequacy test

At each end of the reporting period, liability adequacy tests are performed to ensure the adequacy of the contract liabilities net of related deferred acquisition costs. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to profit or loss initially by writing off DAC and by subsequently establishing a provision for losses arising from liability adequacy tests (the unexpired risk provision as described above). Any DAC written off as a result of this test cannot subsequently be reinstated.

(f) Investment contracts without DPF

The Group issues investment contracts without DPF.

Premium arising on these contracts is classified as a financial liability – investment contracts without DPF. The fair value of these contracts is dependent on the fair value of underlying financial assets. These are designated at inception as fair value through profit or loss. The fair value of a unit linked financial liability is determined using the current unit values that reflect the fair values of the financial assets linked to the financial liability. This is multiplied by the number of units attributed to the contract holder at the balance sheet date.

If the investment contract is subject to a surrender option, the fair value of the financial liability is never less than the amount payable on surrender, where applicable. Other benefits payable are also accrued as appropriate.

2.15 BORROWINGS

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the profit and loss account over the period of the borrowings using the effective interest method.

Fees paid on the establishment of loan facilities are recognised as transaction cost of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fee is deferred until the draw-down occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fee is capitalised as a pre-payment for liquidity services and amortised over the period of the facility to which it relates.

2.16 CURRENT AND DEFERRED INCOME TAX

The tax expense for the period comprises current and deferred tax. Tax is recognised in the profit and loss account, except to the extent that it relates to items recognised in other comprehensive income or directly in equity.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the Company's subsidiaries and associates operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes provision where appropriate.

Deferred income tax is recognised using the liability method for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date.

Deferred tax assets are recognised only to the extent that future taxable profit will be available such that realisation of the related tax benefit is probable.

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

NOTES TO THE FINANCIAL STATEMENTS

2. OTHER ACCOUNTING POLICIES - CONTINUED

2.16 CURRENT AND DEFERRED INCOME TAX - CONTINUED

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on the taxable entity.

Deferred tax related to fair value re-measurements charged or credited directly in other comprehensive income or to equity, is also credited or charged directly to equity and subsequently recognised in the profit and loss account together with the deferred gain or loss.

2.17 PROVISIONS FOR PENSION OBLIGATIONS

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made.

A defined benefit plan defines an amount of pension that an employee will receive on retirement. In the Group's case, this amount is dependent upon an employee's final compensation upon retirement.

The liability recognised in the statement of financial position is the present value of the defined benefit obligation at the end of the reporting period. The present value of a defined benefit obligation is determined by discounting the estimated future cash outflows using interest rate yields of government or high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in assumptions are charged or credited to profit or loss in the period in which they arise.

2.18 REVENUE RECOGNITION

Revenue comprises the fair value for services and is recognised as follows:

(a) Rendering of services

Premium recognition is described in Note 2.14 dealing with insurance contracts and investment contracts with DPF.

Revenue arising from the issue of investment contracts without DPF and other related services offered by the Group, is recognised in the accounting period in which the services are rendered.

Fees include investment management fees arising from services rendered in conjunction with the issue and management of investment contracts where the Group actively manages the consideration received from its customers to fund a return that is based on the investment profile that the customer selected on origination of the instrument. The Group recognises these fees on a straight-line basis over the estimated life of the contract.

The Group charges its customers for management and other related services using the following different approaches:

– Front-end fees are charged to the client on inception. The consideration received is deferred as a liability and recognised over the life of the contract on a straight-line basis.

– Regular fees are charged to the customer periodically (monthly, quarterly, half yearly or annually) either directly or by making a deduction from invested funds. Regular charges billed in advance are recognised on a straight-line basis over the billing period.

NOTES TO THE FINANCIAL STATEMENTS

2. OTHER ACCOUNTING POLICIES - CONTINUED

2.18 REVENUE RECOGNITION - CONTINUED

(a) *Rendering of services* - continued

Other revenue receivable by the Group mainly comprises commission or trailer fees receivable on account of investment or other services provided in an intermediary capacity.

(b) *Dividend income*

Dividend income is recognised in the profit and loss account as part of investment income when the right to receive payment is established.

(c) *Other net fair value gains/(losses) from financial assets at fair value through profit or loss*

Other gains or losses arising from changes in the fair value of the 'Financial assets at fair value through profit or loss' category are presented in the profit and loss account within 'other investment income' or 'investment expenses and charges' in the period in which they arise.

(d) *Interest income*

Interest income from financial assets not classified as fair value through profit or loss is recognised using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument and continues unwinding the discount as interest income.

(e) *Rent receivable*

Rent receivable from investment property is accounted for on an accruals basis in accordance with the substance of the relevant lease agreements.

2.19 INVESTMENT RETURN

Investment return includes dividend income, other net fair value movements on financial assets at fair value through profit or loss (including interest income from financial assets classified as fair value through profit or loss), interest income from financial assets not classified as fair value through profit or loss, rental receivable, share of associated undertaking's result, and is net of investment expenses, charges and interest payable.

Investment return is initially recorded in the non-technical account, except for income attributed to long term business which is recognised immediately in the long term business technical account. A transfer is made from the non-technical account to the general business technical account of the actual investment return on investments supporting the insurance technical provisions. With respect to its Group long-term business the investment return is apportioned between the technical and non-technical profit and loss accounts on a basis which takes into account that technical provisions are fully backed by investments and that intangible assets, property, plant and equipment, and working capital are financed in their entirety from shareholders' funds.

2.20 LEASES

Assets leased out under operating leases are included in investment property. Rental income is recognised in the profit and loss account over the period of the lease to which it relates.

2.21 DIVIDEND DISTRIBUTION

Dividend distribution to the Company's shareholders is recognised as a liability in the period in which the dividends are approved by the Company's shareholders.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS IN APPLYING ACCOUNTING POLICIES

The Group makes estimates and assumptions concerning the future. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Value of in-force business

The subsidiary's value of in-force business is a projection of future shareholders' cash flows expected from contracts in force at the year end, appropriately adjusted for taxation and discounted by a risk adjusted discount rate. In assessing the projected cash flows, the directors assume a long term view of a maintainable level of investment return. This valuation requires the use of a number of assumptions relating to future mortality, persistence, levels of expenses, investment returns and asset allocations over the longer term. This valuation is inherently uncertain and assumptions are reviewed on an annual basis as experience and the reliability of the estimation process develop.

Details of key assumptions, and sensitivity of this intangible asset are provided in Note 16. The impact of the change to key assumptions supporting the value of in-force business as at 31 December 2011 is disclosed in Note 16 to the accounts. In 2010, these assumptions were also deemed to be critical accounting estimates for the purpose of determining the fair value of the investment in the associated undertaking at Company level and for measuring the share of the value of in-force business of the associated company.

4. MANAGEMENT OF RISK

The Group is a party to contracts that transfer insurance risk and/or financial risk. This section summarises these risks and the way that the Group manages them.

4.1 INSURANCE RISK

The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is fortuitous.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Group faces under its insurance contracts is that the actual claims and benefit payments are significantly different to the amounts included within technical provisions. This could occur because the frequency or severity of claims and benefits are greater or lower than estimated. Insurance events are fortuitous and the actual number and amount of claims and benefits may vary from year to year from the estimate established using statistical techniques.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected across the board by a change in any subset of the portfolio. The Group has developed its insurance underwriting strategy to diversify the type of insurance risk accepted and within each of these categories to achieve a sufficiently large population of risks to reduce the potential variability of the expected outcome.

Factors that aggravate insurance risk include lack of risk diversification in terms of type and amount of risk and geographical location. The Group is largely exposed to insurance risk in one geographical area, Malta.

(a) Short term business insurance contracts – general insurance

Frequency and severity of claims

The terms and conditions of the contracts set out the bases for the determination of the Group's liability should the insured event occur. The risks underwritten include accident and health, motor (including third party liability), marine and transport, fire and other damage to property, liability and group life. Details of gross premiums written as well as the insurance liabilities analysed by class are provided in the "Segmental Analysis" (Note 6).

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.1 INSURANCE RISK - CONTINUED

(a) Short term business insurance contracts – general insurance - continued

Frequency and severity of claims - continued

The frequency and severity of claims can be affected by several factors. The following are considered by the Group to be the most significant:

- The increasing levels of court awards in cases where damages are suffered as a result of injuries, the divergence of awards that is dependant on the territory of the claim and the jurisdiction of the court, the effect of inflation due to the prolonged period typically required to settle such cases; and

- The risk of a single event that can extensively affect a multiple of individual risks to which the Group is exposed.

The Group manages these risks through its underwriting strategy, adequate reinsurance arrangements and proactive claims handling.

The underwriting strategy ensures that the risks underwritten are well diversified in terms of type and amount of risk. The Group follows strict underwriting guidelines and sets limits on the overall retention of risk that it carries. Any risk in excess of this limit is either reinsured under a facultative cover note or is declined. Underwriting limits are in place to enforce appropriate risk selection criteria. In certain circumstances, certain exclusions to risks are included within these guidelines. For example, the Group does not insure US risks unless they are incidental. The Group can impose deductibles to help manage its costs. It also uses its experience and expertise to mitigate the risk of fraudulent claims. Insurance contracts also entitle the Group to pursue third parties for payment of some or all of the costs (i.e. subrogation). A significant portion of the Group's business is underwritten through an agency distribution network. Underwriting authority limits are set for individual agencies or branches, and any contracts through which the Group is committed to cover risks in excess of these authority limits require head office approval.

The Group has reinsurance protection in place for all classes of business. The type of reinsurance cover, and the level of retention, is based on the Group's internal risk management assessment which takes into account the risk being covered, the sums assured and the geographical location of the risk. The Board approves each reinsurance program on an annual basis. The reinsurance arrangements include a mix of proportional, facultative and non-proportional covers, which limit the liability of the Group to any one individual claim or event. Generally the Group's is to place reinsurance with listed multinational reinsurance companies whose credit rating is not less than A.

The Group has specialised claims units dealing with the mitigation of risks surrounding known claims. These units investigate and adjust all claims. Claims are reviewed individually on a regular basis. Those claims that take more than one year to settle are reviewed regularly, and are adjusted to reflect the latest information on the underlying facts, current law, jurisdiction, contractual terms and conditions and other factors. The Group actively manages and pursues early settlement of claims to reduce its exposure to unpredictable developments. Authority limits are set for the settlement of claims through the individual agents. Any claims incurred above these limits are referred to head office for handling. In addition, all claims involving bodily injury are referred to head office irrespective of their amount.

Concentration of insurance risk

Up until 31 December 2011, 100% of the Group's business was written in Malta (2010: 92%). The portfolio is diversified in terms of type of business written, with motor comprehensive business comprising 26% (2010: 26%) and accident and health comprising 25% (2010: 24%) of the total portfolio. Other significant insurance business classes include motor liability business at 20% (2010: 20%) and fire and other damage to property at 19% (2010: 20%). The remaining 10% (2010: 10%) of premium written is generated across a spread of classes including marine, other non-motor liability business and long term business. Further information on premiums written, and claims incurred by insurance business class is provided in Note 6 to these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.1 INSURANCE RISK - CONTINUED

(a) Short term business insurance contracts – general insurance - continued

Sources of uncertainty in the estimation of future claim payments

Claims on contracts are accounted for on a claims-occurrence basis. The Group is liable for all insured events that occurred during the term of the contract, even if the loss is discovered after the end of the contract term. Certain classes of business, most notably those exposed to liability, can take several years to develop and are therefore subject to a greater degree of uncertainty than other classes of business which are typically settled in a shorter period of time.

The estimated cost of claims includes direct expenses to be incurred in settling claims, net of the expected subrogation value and recoveries. The Group takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is possible that the final outcome will prove to be different from the original liability established.

In calculating the estimated cost of unpaid claims, the Group considers the results of estimation techniques, that are based partly on known information at year-end and partly on statistical analysis of historical experience. The Company has constructed 'chain ladders' that triangulate the settlement of claims by accounting year or underwriting year, depending on the class of business. The 'chain ladders' include the known claims incurred (i.e. the claims paid and claims outstanding in any given year) by underwriting/accounting year, and they demonstrate how each year has progressed in the subsequent years of development. The 'chain ladder' is then projected forward giving greater weighting to recent years. Allowance is made, however, for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims.

Note 23 presents the development of the estimate of ultimate claim cost for claims notified in a given year.

(b) Long term business insurance contracts

Frequency and severity of claims

For contracts where death is the insured risk, the most significant factor that could increase the overall frequency of claims are epidemics or wide spread changes in lifestyle resulting in earlier or more claims than expected.

At present these risks do not vary significantly in relation to the location of the risk insured by the Group. However, undue concentration by amounts could have an impact on the severity of benefit payments on a portfolio basis.

For contracts with fixed and guaranteed benefits and fixed future premiums, there are no mitigating terms and conditions that reduce the insurance risk accepted. For contracts with DPF, the participating nature of the contracts results in a portion of the insurance risk being reduced over the term of policy. Investment contracts with DPF carry negligible insurance risk.

The Group manages these risks through its underwriting strategy and reinsurance arrangements. The underwriting strategy is intended to ensure that the risks underwritten are well diversified in terms of type of risk and level of insured benefits. Medical selection is also included in the Group's underwriting procedures with premiums varied to reflect the health condition and life expectancy of the applicants.

The Group has reinsurance protection in place to cover all death claims. The type of reinsurance cover and the level of retention for each risk are based on the Group's internal risk management assessment, which takes account of the nature of the risk covered and the sum assured. The reinsurance program is approved by the Board annually. The reinsurance arrangements in place include a mix of treaty, facultative, excess of loss and catastrophe protection, which limits the liability of the Group to any one individual life or event. The Group's reinsurance is placed with listed multinational reinsurance companies whose rating is not less than A.

Sources of uncertainty in the estimation of future benefit payments and premium receipts

Uncertainty in the estimation of future benefit payments and premium receipts for long term insurance contracts arises from the unpredictability of long term changes in overall levels of mortality, and the variability in contract holder behaviour. The Group uses appropriate base tables of standard mortality according to the type of contract being written. The Group does not take credit for future lapses in determining the liability for long term contracts.

Further detail on insurance risk is provided in Note 23 to these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.2 FINANCIAL RISK

(a) Market risk

The Group is exposed to financial risks through its financial assets, financial liabilities and insurance and reinsurance assets and liabilities. In particular, the key risk is that in the long term, the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance and investment contracts. The components of financial risks for the Group are market risk (including cash flow and fair value interest rate risk, equity price risk and currency risk), credit risk and liquidity risk. These risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The risks that the Group primarily faces due to the nature of its assets and liabilities are interest rate risk and equity price risk.

The Group is developing its Asset/Liability management framework to further support the manner in which these risk positions are managed. It actively manages its assets to achieve a competitive rate of return within risk objectives delineated by asset liquidity measures, duration targets and credit quality parameters. The respective Investment Committees review and approve investment strategies on a periodic basis ensuring that assets are managed efficiently and within approved risk mandates.

i) Cash flow and fair value interest rate risk

In general, the Group is exposed to risk associated with the effects of fluctuations in the prevailing levels of market interest rates. Several line items on the balance sheet are based on fixed interest rates, and are therefore subject to changes in fair value resulting from changes in market rates. This risk is managed through investment in debt securities and deposits having a wide range of maturity dates. Group investment parameters exist to limit exposure to any one particular issuer and any one particular security (with the exception of investment in government securities). The Group also has assets as well as loan facilities issued at variable rates which expose it to cash flow interest rate risk. Periodic reports are prepared at portfolio, legal entity and asset and liability class level that are circulated to the Group's relevant key management personnel.

Short term insurance and other liabilities are not directly sensitive to the level of market interest rates, as they are not discounted. In those instances where interest is payable (e.g. in the case of damages awarded by the Courts), interest is included in the claims cost whilst the investment income earned until the claim is settled is credited to the profit and loss account as it accrues.

Insurance and investment contracts with DPF at Group level have benefit payments that are fixed and guaranteed at the inception of the contract (for example, sum assured), or as annual discretionary bonuses are declared. The Group's primary financial risk on these contracts is the risk that interest income and capital redemptions from the financial assets backing the liabilities are insufficient to fund the guaranteed benefits payable.

With the exception of the unit linked capital guaranteed products, the Group does not guarantee a positive fixed rate of return to its long-term contract policyholders at the inception of a contract. The declaration of discretionary bonuses is guided by the bonus policy that is approved by the Board of Directors. Once a reversionary bonus is declared, it is guaranteed to be paid in full at maturity or on the prior death of the life assured. The bonus policy considers historic and current rates of return generated by the Group's investment portfolio as well as the Group's expectations for future investment returns. The impact of interest rate risk is mitigated by the presence of the DPF. These guaranteed benefits increase as discretionary benefits are declared and allocated to contract holders.

In the case of the unit linked capital guaranteed products, the Group has guaranteed a fixed return for certain periods of each contract. Subsequent to the expiry of the guarantee, the policyholders will receive a return analogous to that being generated by the underlying units. In addition, the Group has also guaranteed any shortfall in the carrying value of the underlying assets on maturity as compared to the initial capital investment. In order to mitigate this risk, the Group has contracted a back to back guarantee with international financial service providers, which ensures that any shortfall on the guaranteed capital investment return, will be compensated by these providers. On entering this agreement the Group considered the reputation and credit worthiness of these partners taking into account, amongst other factors, the credit rating as graded by international rating agencies. The Group monitors this rating regularly.

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.2 FINANCIAL RISK - CONTINUED

(a) Market risk - continued

i) Cash flow and fair value interest rate risk - continued

All insurance and investment contracts with a DPF feature can be surrendered before maturity for a cash surrender value that is always less than actual contract liability. Cash surrender values are determined at the discretion of the Group, and can be varied from time to time. The primary factor affecting the level of cash surrender value is the investment return earned on the assets of the Group. In addition, the cash surrender value is affected by the expenses, tax and the cost of risk benefits (such as life cover) borne by the Group, deductions to provide a return to shareholders, as well as profits and losses arising on other contracts. The expenses include payment of commission, medical report expenses, office administration costs and other expenses incurred in the setting up and maintenance of the contract. At most, the cash surrender value will be the amount of the actual liability reduced by the surrender charge (where applicable). Furthermore, in respect of all contracts with DPF (with the exception of some contracts that have been in force more than a certain number of years), the Group reserves the right to increase the level of surrender charge and, if necessary, to apply a Market Value Reduction (MVR). A MVR is a deduction which the Group may make on surrender of a contract with DPF. For example, if the underlying investment return, after allowing for expenses, tax, risk benefits, shareholder returns and adjustment for profits or losses on other contracts is less than the return already provided for in the form of reversionary bonuses, the Group may decide to apply an MVR.

The MVR serves to protect the interests of remaining investors and the Group, who would otherwise have to subsidise the amount paid on surrendering contracts. The Group does not apply a standard percentage deduction on all contracts but determines the deduction to apply to each individual surrender at the time the surrender is made. The amount depends on a number of factors including the length of time the contract has been in force, and the underlying investment return over the same time period. There will be no MVR at maturity or on death. This means that at maturity or on death the payment of the actual contract liability is guaranteed. The cash surrender value may also be less than the total amount of premiums paid up to the date of surrender. The Group is not required to, and does not, measure the effect of the above embedded derivative at fair value.

The Group matches its insurance liabilities with a diversified portfolio of assets which includes equity, debt securities and property. The return from debt and cash based securities is subject to interest rate risk.

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.2 FINANCIAL RISK - CONTINUED

(a) Market risk - continued

i) Cash flow and fair value interest rate risk - continued

Assets and liabilities exposed to interest rate risk and their maturities are analysed below:

	2011				
Group	Within 1 year €'000	Between 1 – 2 years €'000	Between 2 – 5 years €'000	Over 5 years €'000	Total €'000
Assets					
Debt securities – listed fixed interest rate	7,094	45,390	156,052	328,503	537,039
Collective investment schemes	6,287	-	-	-	6,287
Loans and receivables:					
- Deposits with banks and credit institutions	173,894	5,000	-	-	178,894
- Loans secured on policies	11,619	-	-	-	11,619
- Cash and cash equivalents	7,380	-	-	-	7,380
Total interest bearing assets	206,274	50,390	156,052	328,503	741,219
Liabilities					
Long-term insurance contracts	-	-	-	943,618	943,618
Borrowings	-	-	-	8,500	8,500
Deposits received from reinsurers	165	-	-	-	165
Total interest bearing liabilities	165	-	-	952,118	952,283

	2010				
Group	Within 1 year €'000	Between 1 – 2 years €'000	Between 2 – 5 years €'000	Over 5 years €'000	Total €'000
Assets					
Debt securities – listed fixed interest rate	754	3,021	5,476	4,298	13,549
Loans and receivables:					
- Deposits with banks and credit institutions	22,360	-	-	-	22,360
- Cash and cash equivalents	2,734	-	-	-	2,734
Total interest bearing assets	25,848	3,021	5,476	4,298	38,643
Liabilities					
Borrowings	2,326	2,326	6,133	2,500	13,285
Deposits received from reinsurers	4,616	-	-	-	4,616
Total interest bearing liabilities	6,942	2,326	6,133	2,500	17,901

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.2 FINANCIAL RISK - CONTINUED

(a) Market risk - continued

i) Cash flow and fair value interest rate risk - continued

2011

Company	Within 1 year €'000	Between 1 - 2 years €'000	Between 2 - 5 years €'000	Over 5 years €'000	Total €'000
Assets					
Debt securities – listed fixed interest rate	-	3,221	2,857	3,978	10,055
Loans and receivables:					
- Deposits with banks and credit institutions	12,600	-	-	-	12,600
- Cash and cash equivalents	952	-	-	-	952
Total interest bearing assets	13,552	3,221	2,857	3,978	23,607
Liabilities					
Borrowings	-	-	-	2,500	2,500
Deposits received from reinsurers	165	-	-	-	165
Total interest bearing liabilities	165	-	-	2,500	2,665

2010

Company	Within 1 year €'000	Between 1 - 2 years €'000	Between 2 - 5 years €'000	Over 5 years €'000	Total €'000
Assets					
Debt securities – listed fixed interest rate	754	3,021	5,476	3,802	13,053
Loans and receivables:					
- Deposits with banks and credit institutions	22,360	-	-	-	22,360
- Cash and cash equivalents	1,875	-	-	-	1,875
Total interest bearing assets	24,989	3,021	5,476	3,802	37,288
Liabilities					
Borrowings	2,326	2,326	6,133	2,500	13,285
Deposits received from reinsurers	4,616	-	-	-	4,616
Total interest bearing liabilities	6,942	2,326	6,133	2,500	17,901

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.2 FINANCIAL RISK - CONTINUED

(a) Market risk - continued

i) Cash flow and fair value interest rate risk - continued

Assets and liabilities issued at variable rates expose the Group to cash flow interest rate risk whilst assets and liabilities issued at fixed rates expose the Group to fair value interest rate risk. The overall exposure to these two risks are as follows:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Assets held at variable rates				
Collective investment schemes	**6,287**	-	**-**	-
Deposits with banks or credit institutions	**822**	-	**-**	-
Cash and cash equivalents	**7,380**	2,734	**952**	1,875
	14,489	2,734	**952**	1,875
Liabilities issued at variable rates				
Long-term insurance contracts	**943,618**	-	**-**	-
Borrowings	**8,500**	13,285	**2,500**	13,285
Deposits received from reinsurers	**165**	4,616	**165**	4,616
	952,283	17,901	**2,665**	17,901

Interest rate risk in relation to linked liabilities for contracts that also combine a discretionary feature has been excluded as the directors consider the exposure to be insignificant.

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Assets held at fixed rates				
Loans secured on polices	**11,619**	-	**-**	-
Deposits with banks on credit institutions	**178,072**	22,360	**12,600**	22,360
Debt securities	**537,039**	13,549	**10,055**	13,053
	726,730	35,909	**22,655**	35,413

Up to the balance sheet date the Group did not have any hedging policy with respect to interest rate risk as exposure to such risks was not deemed to be significant by the directors.

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.2 FINANCIAL RISK - CONTINUED

(a) Market risk - continued

i) Cash flow and fair value interest rate risk - continued

Sensitivity Analysis – interest rate risk

The sensitivity analysis for interest rate risk illustrates how changes in the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates at the reporting date.

The interest rate sensitivity, which considers the impact of changes in interest rates on financial assets and financial liabilities, has been based on a model of Euro Swap rates, being the Group's and Company's largest exposure. The sensitivity chosen aims to reflect a 1 in 10 year event.

At 31 December 2011, if interest rates at that date would have been 90 basis points (2010: 90 basis points) lower with all other variables held constant, the Group and Company pre-tax results for the year would have improved by €0.32 million (2010: €0.41 million) and €0.26 million (2010: €0.41 million) respectively. An increase of 90 basis points (2010: 90 basis points), with all other variables held constant, would have resulted in a decrease in the Group's and Company's pre-tax results for the year of €3.56 million (2010: €0.38 million) and €0.24 million (2010: €0.38 million) respectively.

ii) Equity price risks

The Group's financial assets are susceptible to the risk of decreases in value due to changes in the prices of equities because of investments held and classified on the balance sheet as fair value through profit or loss or as available-for-sale.

The directors manage this risk of price volatility by entering into a diverse range of investments including equities and collective investment schemes. In addition, the Group's investments are spread geographically in a diverse number of different "Zone A and EEA". The Group has an active Investment Committee that has established a set of investment guidelines that is also approved by the Board of Directors. Investments over prescribed limits are directly approved by the Board. These guidelines provide parameters for investment management, including contracts with external portfolio managers. They include, *inter alia*, reference to an optimal spread of the investment portfolio, minimum security ratings assessment of equity issuers and maximum exposures by the Group to any one issuer and its connected parties. These parameters also consider solvency restrictions imposed by the Regulator.

4. MANAGEMENT OF RISK - CONTINUED

4.2 FINANCIAL RISK - CONTINUED

(a) Market risk - continued

ii) Equity price risks - continued

Management structures are in place to monitor all the Group's overall market positions on a frequent basis. Reports are prepared at portfolio, legal entity and asset and liability class level that are circulated to the Group's relevant key management personnel. These are also reviewed on a monthly basis by the Investment Committee and on a quarterly basis by the Board.

The total assets subject to equity price risk are the following:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Assets subject to equity price risk	**245,077**	4,914	**2,979**	4,914

In the case of assets held to cover unit-linked liabilities the exposure is carried by the contract holder. In the case of capital guaranteed products any shortfalls guaranteed upon maturity are mitigated by a back to back guarantee with international financial service providers as further referred in 4.2 (a) (i).

The sensitivity for equity price risk illustrates how changes in the fair value of equity securities (excluding investments in associated undertakings) will fluctuate because of changes in market prices, whether those changes are caused by factors specific to the individual equity issuer, or factors affecting all similar equity traded in the market.

The sensitivity for equity price risk (excluding investments in associated undertakings) is derived based on global equity returns, assuming that currency exposures are hedged. The sensitivities chosen aim to reflect a 1 in 10 year event. Given the investment strategy of the Group and Company, a 10% positive or negative movement in equity prices is considered to be an appropriate benchmark for sensitivity purposes.

An increase and a decrease of 10% in equity prices, with all other variables held constant, would result in a positive impact of €3.70 million (2010: €0.49 million) and a negative impact of €3.90 million (2010: €0.49 million) on the Group's pre-tax profit and a positive or negative impact of €0.30 million on the Company's pre-tax results (2010: €0.49 million).

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.2 FINANCIAL RISK - CONTINUED

(a) Market risk - continued

iii) Currency risk

The Group and Company have assets and liabilities denominated in major international currencies other than Euro. The Group and Company are therefore exposed to currency risk, as the value of assets and liabilities denominated in other currencies will fluctuate due to changes in exchange rates. The Group's hedges its foreign currency denominated debt securities using forward exchange contracts in order to mitigate the risk that principal cash flows of these investments fluctuate as a result of changes in foreign exchange risk. The Group is also exposed to foreign currency risk arising from its equity securities denominated in major international currencies. At 31 December 2011, foreign currency exposure amounted to €44.19 million (2010: €0.12 million). These exposures were unhedged as at the respective financial year-end. Due to an increasingly globalised economy, the Group's equity investments are diversified across various currencies. The directors consider that the exposure to currency risk is appropriately captured in the equity price risk sensitivity above.

The Group's and Company's exposure to exchange risk is limited through the establishment of guidelines for investing in foreign currency and hedging currency risk through forward exchange contracts where considered necessary. These guidelines are approved by the respective Boards and a manageable exposure to currency risk is thereby permitted.

The Company also operates in Gibraltar creating an additional source of foreign currency risk – GBP.

- The operating results of the Group's foreign branches are translated at average exchange rates prevailing during the period in the financial statements; and
- The investment in foreign branches is translated into Euro using the foreign currency exchange rate at the financial statement period-end date.

(b) Credit risk

Credit risk is the risk of decreases in value when counterparties are not capable of fulfilling their obligations or when a change in their credit status takes place. Key areas where the Group is exposed to credit risk are:

- Investments and cash and cash equivalents
- Reinsurers' share of insurance liabilities
- Amounts due from reinsurers in respect of claims already paid
- Amounts due from insurance contract holders
- Amounts due from insurance intermediaries
- Counterparty risk with respect to forward foreign exchange controls

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.2 FINANCIAL RISK - CONTINUED

(b) Credit risk - continued

The Group places limits on the level of credit risk undertaken from the main categories of financial instruments. These limits also take due consideration of the solvency restrictions imposed by the relevant Regulations. The investment strategy of the Group considers the credit standing of the counterparty and control structures are in place to assess and monitor these risk thresholds.

The Group structures the levels of credit risk it accepts by limiting as far as possible its exposure to a single counterparty or groups of counterparties. The Group has in place internal control structures to assess and monitor credit exposures and risk thresholds.

The Group's cash is placed with a number of quality financial institutions, thereby reducing the concentration of counterparty credit risk to an acceptable level.

Reinsurance is used to manage insurance risk. This does not, however, discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the Group remains liable for the payment to the policyholder. The creditworthiness of reinsurers is monitored on a quarterly basis by reviewing credit grades provided by rating agencies and other publicly available financial information, thereby ensuring the continuous financial strength of the reinsurer. At the same time as the Board approves the overall reinsurance protection of the Group, it ensures that the reinsurers' credit rating (either Standard & Poors or equivalent) is within the parameters set by it.

The Group is exposed to contract holders and intermediaries for insurance premium. Credit agreements are in place in all cases where credit is granted, and in the case of certain larger risks, premium payment warranties are in place. This limits the liability of the Group towards the insured or any third party if the premium remains unsettled after the credit period granted and allows the Group to cancel the policy *ab initio*, if considered necessary. Records are kept of the payment history for significant contract holders and intermediaries with whom regular business is conducted. Credit is not granted to contract holders or intermediaries whose payment history is not satisfactory. Credit risk with respect to debtors is further limited due to the large number of customers comprising the Group's debtor base.

The exposure to individual counterparties is also managed by other mechanisms, such as the right to offset where counterparties are both debtors and creditors of the Group. Management information reported to the Group includes details of provisions for impairment on loans and receivables and subsequent write-offs. Internal audit performs regular reviews to assess the degree of compliance with the Group's procedures on credit.

The Group does not trade in derivative contracts, with the exception of forward contracts that are transacted for the purpose of hedging foreign currency exposure as described earlier. All forward contracts are placed with quality financial institutions within the parameters of a hedging policy approved by the Board.

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.2 FINANCIAL RISK - CONTINUED

(b) Credit risk - continued

At 31 December 2011, the Group held exchange traded futures with a notional value of €0.77 million. The futures contracts are collateralised by cash and at 31 December 2011, the Group held cash of €0.07 million as collateral.

The total assets bearing credit risk are the following:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Debt securities	**537,039**	13,549	**10,055**	13,053
Other financial assets (including deposits with banks and credit institutions)	**178,894**	22,360	**12,600**	22,360
Reinsurers share of technical provisions	**11,152**	9,873	**10,924**	9,873
Insurance and other receivables	**20,648**	9,786	**8,579**	9,577
Income tax receivable	**4,725**	331	**416**	291
Cash and cash equivalents	**7,380**	2,734	**952**	1,875
Total	**759,838**	58,633	**43,526**	57,029

The carrying amounts disclosed above represent the maximum exposure to credit risk.

These assets are analysed in the table below using Standard & Poors rating (or equivalent).

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
AAA	**75,513**	-	**-**	-
AA	**25,774**	13,863	**10,275**	13,863
A	**424,027**	13,222	**11,533**	12,684
BBB	**133,764**	13,907	**4,525**	13,528
Not rated	**100,708**	17,641	**17,193**	16,954
	759,838	58,633	**43,526**	57,029

The company does not hold any collateral as security to its credit risk.

4. MANAGEMENT OF RISK - CONTINUED

4.2 FINANCIAL RISK - CONTINUED

(b) Credit risk - continued

Financial assets that are past due but not impaired

The following insurance and other receivables are classified as past due but not impaired:

	Group and Company	
	2011	2010
	€'000	€'000
Within credit terms	**3,079**	3,336
Not more than three months	**1,696**	1,667
Within three to twelve months	**309**	925
Over twelve months	**297**	404
	5,381	6,332

IFRS 7 defines a financial asset as being past due when the counterparty has failed to make a payment when contractually due. It goes further to stipulate that full disclosure must be made of all balances due from this particular counterparty, including those which are still within credit terms and therefore not contractually due.

The overall exposure of the Group in terms of IFRS 7 is €5.38 million (2010: €6.33 million), of which €3.08 million (2010: €3.34 million) is not contractually due. It is the view of the directors that no impairment charge is necessary, due to the following reasons:

1. Settlements after year-end.
2. In cases where the amount has not been settled, agreement for settlement has been reached or is being negotiated.

Trade receivables at 31 December 2011 comprise amounts of €0.52 million whose terms have been renegotiated from the original terms and which are classified as fully performing.

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.2 FINANCIAL RISK - CONTINUED

(b) Credit risk - continued

Financial assets that are impaired

Within insurance and other receivables are the following receivables that are classified as impaired:

	Group and Company	
	2011	2010
	€'000	€'000
Over twelve months	**123**	618
	123	618

These balances are covered by the following:

	Group and Company	
	2011	2010
	€'000	€'000
Provision for impairment of receivables (Note 25)	**123**	496
Other insurance payables	**-**	122
	123	618

A decision to impair an asset is based on the following information that comes to the attention of the Group:

- Significant financial difficulty of the debtor.
- It becoming probable that the debtor will enter bankruptcy or other financial reorganisation.

(c) Liquidity risk

Liquidity risk is the risk of not being able to meet unexpected or unexpectedly high payments in the short term, hence incurring a financial loss through the disposal of assets at an unfavourable price.

The Group is exposed to daily calls on its available cash resources mainly from claims arising from insurance contracts. Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Group manages its funds in such a manner as to ensure an adequate portion of available funds to meet such calls, principally through limits set by the Board on the minimum proportion of maturing funds available to meet such calls. Furthermore, the Group invests a majority of its assets in listed investments that can be readily disposed of.

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.2 FINANCIAL RISK - CONTINUED

(c) Liquidity risk - continued

The following table indicates the expected timing of cash flows arising from the Group's liabilities:

	Group expected cash flows (undiscounted) (€ millions) 2011						
	0-1 yr	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	>5yrs	Total
Technical provisions – Life insurance contracts and investment contracts with DPF	23.0	22.0	30.0	58.0	92.0	1,183.0	1,408.0
Technical provisions – claims outstanding	18.0	6.7	4.0	2.5	1.0	8.0	40.2
Borrowings	0.5	0.5	0.5	0.5	0.5	9.1	11.6
Insurance and other payables	13.4	-	-	-	-	-	13.4

Expected cash flows on unit linked liabilities have not been included as the directors consider that there is limited exposure to liquidity risk given that these are principally backed by unit linked assets.

	Group expected cash flows (undiscounted) (€ millions) 2010						
	0-1 yr	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	>5yrs	Total
Technical provisions – claims outstanding	17.9	6.4	4.2	2.0	1.3	8.0	39.8
Borrowings	2.9	2.7	2.6	2.6	1.6	2.8	15.2
Insurance and other payables	12.7	-	-	-	-	-	12.7

	Company expected cash flows (undiscounted) (€ millions) 2011						
	0-1 yr	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	>5yrs	Total
Technical provisions – claims outstanding	18.0	6.7	4.0	2.5	1.0	8.0	40.2
Borrowings	0.1	0.1	0.1	0.1	0.1	2.7	3.2
Insurance and other payables	8.9	-	-	-	-	-	8.9

	Company expected cash flows (undiscounted) (€ millions) 2010						
	0-1 yr	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	>5yrs	Total
Technical provisions – claims outstanding	17.9	6.4	4.2	2.0	1.3	8.0	39.8
Borrowings	2.9	2.7	2.6	2.6	1.6	2.8	15.2
Insurance and other payables	13.8	-	-	-	-	-	13.8

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.3 FAIR VALUES

The following table presents the assets measured in the balance sheet at fair value by level of the following fair value measurement hierarchy at 31 December 2011:

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

Group

	Level 1	Level 2	Level 3	Total
	€'000	€'000	€'000	€'000
Assets				
Financial assets at fair value through profit or loss				
- Equity securities	328,348	502	33	328,883
- Debt securities	536,207	-	-	536,207
Other available-for-sale investments	832	-	128	960
Investment in associated undertakings	4,806	-	402	5,208
Total assets	**870,193**	**502**	**563**	**871,258**
Liabilities				
Unit linked financial liabilities	89,189	-	-	89,189
Derivative financial instruments	-	(189)	-	(189)
Total liabilities	**89,189**	**(189)**	**-**	**89,000**

Company

	Level 1	Level 3	Total
	€'000	€'000	€'000
Assets			
Financial assets at fair value through profit or loss			
- Equity securities	2,979	-	2,979
- Debt securities	9,223	-	9,223
Other available-for-sale investments	832	-	832
Investment in associated undertakings	-	147	147
Total assets	**13,034**	**147**	**13,181**

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.3 FAIR VALUES - CONTINUED

The following tables present the assets measured at fair value at 31 December 2010.

Group

	Level 1 €'000	Level 3 €'000	Total €'000
Assets			
Financial assets at fair value through profit or loss			
- Equity securities	4,914	-	4,914
- Debt securities	13,549	-	13,549
Other available-for-sale investments	-	153	153
Total assets	**18,463**	**153**	**18,616**

Company

	Level 1 €'000	Level 3 €'000	Total €'000
Assets			
Financial assets at fair value through profit or loss			
- Equity securities	4,914	-	4,914
- Debt securities	13,053	-	13,053
Other available-for-sale investments	-	21	21
Investment in associated undertakings	-	55,473	55,473
Total assets	**17,967**	**55,494**	**73,461**

Fair value measurements classified as Level 1 include exchange-traded prices of fixed maturities and equity securities.

Level 3 securities constitute investment in unlisted equities. Fair values were determined by using valuation techniques. Determination to classify fair value measures within Level 3 of the valuation hierarchy are generally based on the significance of the unobservable factors to the overall fair value measurement.

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.3 FAIR VALUES- CONTINUED

The following table presents the changes in Level 3 instruments for the year ended 31 December 2011.

Group	**Other available-for-sale investments** €'000	**Total** €'000
Opening balance	153	153
Recognition of subsidiary	33	33
Disposals	(21)	(21)
Net fair value losses	(4)	(4)
Closing balance	**161**	**161**

Company	**Investments in associates** €'000	**Other available-for-sale investments** €'000	**Total** €'000
Opening balance	55,473	21	55,494
Additions	147	-	147
Disposal	-	(21)	(21)
Transfer to investment in group undertaking	(56,002)	-	(56,002)
Net fair value gains	529	-	529
Closing balance	**147**	**-**	**147**

The following table presents the changes in Level 3 instruments for the year ended 31 December 2010.

Group	**Other available-for-sale investments** €'000	**Total** €'000
Opening balance	410	410
Disposals	(262)	(262)
Net fair value gains	5	5
Closing balance	**153**	**153**

NOTES TO THE FINANCIAL STATEMENTS

4. MANAGEMENT OF RISK - CONTINUED

4.3 FAIR VALUES - CONTINUED

Company	**Investments in associates** €'000	**Other available-for-sale investments** €'000	**Total** €'000
Opening balance (restated) - Note 20	51,957	75	52,032
Additions	1,500	-	1,500
Disposal	-	(12)	(12)
Net fair value gains/(losses)	2,016	(42)	1,974
Closing balance	**55,473**	**21**	**55,494**
Total losses for the period included in profit and loss account	-	**(42)**	**(42)**

At 31 December 2011 and 2010, the carrying amount of the Group's and Company's other financial assets and liabilities approximated their fair values with the exception of the subsidiary's financial liabilities emanating from investment contracts with DPF. It is impractical to determine the fair value of these contracts due to the lack of a reliable basis to measure the future discretionary return that is a material feature of these contracts.

5. CAPITAL MANAGEMENT

The Group's objectives when managing capital are:

- To comply with the insurance capital requirements established by the regulators of the insurance markets in which the Group operates;
- To provide for the capital requirements of the companies within the Group;
- To safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- To provide an adequate return to shareholders by pricing insurance contracts commensurately with the level of risk.

The defined regulatory capital for Middlesea Insurance p.l.c. ("MSI" or "the Company") comprises shareholders' equity and subordinated loans. The minimum own funds required by Insurance Rule 1 at 31 December 2011 amounted to €7.0 million (2010: €7.0 million). In addition, the Insurance Business Regulations stipulate 'the required margin of solvency' that the Company is required to hold. Regulatory capital requirements may be set at a multiple of this requirement. The minimum required capital must be maintained at all times throughout the year. Given the composite nature of the Company, Middlesea Insurance p.l.c. is obliged to abide with capital requirements for both its long term and its general insurance business.

5. CAPITAL MANAGEMENT - CONTINUED

The minimum capital regulatory requirements of the Company as at 31 December 2011 amounted to €7.5 million (2010: €7.6 million). At 31 December 2011, the regulatory capital held by the Company represented by admissible assets exceeded the minimum capital regulatory requirement and also the multiple set by the Regulator. The Company was compliant at all times during the year with its capital requirements with respect to both its general and long-term business. As reported in the 2010 financial statements, the Company had not met its regulatory capital requirement during the first six months of 2010 but this position was rectified by the second half of that year.

All other companies within the Group were also compliant with the respective minimum regulatory requirements throughout the financial period.

6. SEGMENT INFORMATION

Management has determined the operating segments based on the reports reviewed by the Executive Management team that are used to make strategic decisions. In identifying the Group's business segments, the chief operating decision-maker is also guided by the Regulations under the Insurance Business Act, 1998 on the disclosure requirements relevant to specified insurance classes of business.

The Company mainly writes its business from Malta. In the previous year, the Company had also operated a branch in Gibraltar carrying on general business of insurance, which as from 1 January 2011 was put in run-off.

The Group's geographic segments operate in two main business segments, general business, that is further sub-divided into various insurance business classes, and long-term business. The segment results for the years ended 31 December 2011 and 2010 are indicated below.

General business

Gross premiums written and gross premiums earned by class of business

	Group and Company			
	Gross premiums written		Gross premiums earned	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Direct insurance				
Motor (third party liability)	**5,968**	6,681	**6,285**	6,477
Motor (other classes)	**8,072**	8,590	**8,501**	8,329
Fire and other damage to property	**5,823**	6,607	**6,102**	6,476
Accident and health	**7,507**	8,062	**7,543**	7,790
Other classes	**3,077**	3,215	**3,059**	3,146
	30,447	33,155	**31,490**	32,218

NOTES TO THE FINANCIAL STATEMENTS

6. SEGMENT INFORMATION - CONTINUED

General business - continued

100% (2010: 92%) of consolidated gross premiums written for direct general insurance business emanate from contracts concluded in or from Malta. During 2010, 8% of the premiums written emanated from contracts concluded in or from Gibraltar. All premiums emanate from external customers and there is no business transacted between segments other than as disclosed in Note 36.

Gross claims incurred, gross operating expenses and reinsurance balance by class of business

	Group and Company					
	Gross claims incurred		**Gross operating expenses**		**Reinsurance balance**	
	2011	2010	**2011**	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000	**€'000**	€'000
Direct insurance						
Motor (third party liability)	**5,212**	6,858	**2,120**	1,953	**(41)**	46
Motor (other classes)	**4,307**	4,074	**2,873**	2,511	**(29)**	61
Fire and other damage to property	**2,762**	2,132	**2,072**	1,975	**1,605**	2,170
Accident and health	**3,917**	4,354	**2,165**	1,970	**308**	1,100
Other classes	**772**	547	**1,016**	928	**802**	336
	16,970	17,965	**10,246**	9,337	**2,645**	3,713

The reinsurance balance represents the charge/(credit) to the technical account arising from the aggregate of all items relating to reinsurance outwards.

Long term business

(i) Gross premium written

	Group		**Company**	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Gross premiums written				
Direct insurance	**46,673**	1,888	**1,374**	1,888
Reinsurance inwards	**6**	9	**6**	9
	46,679	1,897	**1,380**	1,897

6. SEGMENT INFORMATION - CONTINUED

Long term business - continued

(i) Gross premium written - continued

The long-term business is mainly written through its subsidiary undertaking MSV Life p.l.c. ("MSV"). As further explained in Note 33, MSV became a subsidiary as from 29 July 2011 and premiums written by this group company are reflected accordingly for the period between 29 July 2011 and 31 December 2011.

Group direct insurance is further analysed between:

	Periodic premiums		**Single premiums**	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Non-participating	**4,513**	1,888	**-**	-
Participating	**12,087**	-	**28,565**	-
Linked	**1,289**	-	**219**	-
	17,889	1,888	**28,784**	-

In addition to the above, premium credited to liabilities in Note 23 in relation to linked products classified as investment contracts without DPF was as follows:

	Periodic premiums		**Single premiums**	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Investment contracts	**519**	-	**179**	-

Gross premiums written by way of direct business of insurance relate to individual business and group contracts. All long term contracts of insurance are concluded in or from Malta.

(ii) Reinsurance balance

The reinsurance balance, which represents the aggregate of all items relating to reinsurance outwards mainly attributable to insurance contracts included in the long-term business technical account are as follows:

	Group		**Company**	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Charge for reinsurance outwards	**3,978**	231	**392**	231

NOTES TO THE FINANCIAL STATEMENTS

6. SEGMENT INFORMATION - CONTINUED

Long term business - continued

(iii) Analysis between insurance and investment contracts

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Gross premiums written				
Insurance contracts	**14,923**	1,897	**1,380**	1,897
Investment contracts with DPF	**31,756**	-	**-**	-
	46,679	1,897	**1,380**	1,897
Claims incurred, net of reinsurance				
Insurance contracts	**7,737**	218	**195**	218
Investment contracts with DPF	**20,806**	-	**-**	-
	28,543	218	**195**	218

Reconciliation of reportable segment profit to profit or loss for the financial year before tax

	Group	
	2011	2010
	€'000	€'000
Profit on general business before investment income	**1,629**	1,203
Profit on long term business before investment income	**(2,948)**	457
Net investment income	**6,350**	6,187
Other income	**856**	1,252
Administrative expenses	**(2,777)**	(2,658)
Profit for the financial year before tax	**3,110**	6,441

NOTES TO THE FINANCIAL STATEMENTS

6. SEGMENT INFORMATION - CONTINUED

Reconciliation of reportable segment profit to profit or loss for the financial year before tax - continued

	Company	
	2011	2010
	€'000	€'000
Profit on general business before investment income	**1,629**	1,203
Profit on long term business before investment income	**483**	457
Net investment income	**1,409**	8,762
Administrative expenses	**(1,767)**	(1,565)
Profit for the financial year before tax	**1,754**	8,857

Geographical information

The segment results for the years ended 31 December 2011 and 2010 by geographical area are indicated below:

	Group Gross premiums written		Company Gross premiums written	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Malta	**77,070**	32,327	**31,771**	32,327
Gibraltar – discontinued	**51**	2,716	**51**	2,716
London – discontinued	**5**	9	**5**	9
	77,126	35,052	**31,827**	35,052

NOTES TO THE FINANCIAL STATEMENTS

6. SEGMENT INFORMATION - CONTINUED

Group segment assets and liabilities

The Group operates a business model which does not allocate either assets or liabilities of the operating segments in its internal reporting. Segment assets below consist principally of investments backing up the net technical reserves, reinsurers' share of technical provisions and insurance receivables.

	Motor third party €'000	Motor other €'000	Fire and other damage to property €'000	Accident and health €'000	Other classes €'000	Long-term business €'000	Unallocated €'000	Total €'000
At 31 December 2011								
Assets allocated to business segments	16,761	12,531	10,657	5,261	11,933	1,035,495	8,162	1,100,800
Assets allocated to shareholders	-	-	-	-	-	-	132,645	132,645
Total assets	16,761	12,531	10,657	5,261	11,933	1,035,495	140,807	1,233,445
At 31 December 2010								
Assets allocated to business segments	16,956	13,429	10,264	5,272	11,903	816	9,019	67,659
Assets allocated to shareholders	-	-	-	-	-	-	70,379	70,379
Total assets	16,956	13,429	10,264	5,272	11,903	816	79,398	138,038

The assets allocated to shareholders in 2010 included the aggregate investment in associated undertakings of €53.0 million. As described further in Note 33, MSV Life p.l.c. became a subsidiary during the year and therefore, its assets are now fully consolidated on a line-by-line basis in the table above. These assets are principally allocated to 'long-term business'.

The total of non current assets, other than financial instruments, deferred tax assets, post employment benefits and risks arising under insurance contracts of €116.05 million (2010: €9.75 million) are all located in Malta.

NOTES TO THE FINANCIAL STATEMENTS

7. NET OPERATING EXPENSES

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Acquisition costs	**9,887**	7,466	**7,480**	7,466
Change in deferred acquisition costs, net of reinsurance	**34**	(108)	**34**	(108)
Administrative expenses	**7,447**	5,148	**4,682**	4,055
Reinsurance commissions and profit participation	**(4,968)**	(4,492)	**(4,665)**	(4,492)
	12,400	8,014	**7,531**	6,921
Allocated to:				
General business technical account	**5,783**	5,102	**5,783**	5,102
Long term business technical account	**3,841**	254	**(19)**	254
Non-technical account (administrative expenses)	**2,776**	2,658	**1,767**	1,565
	12,400	8,014	**7,531**	6,921

Total commissions for direct business accounted for in the financial year amounted to €7.97 million (2010: €6.29 million) in the Group's technical result and €6.24 million (2010: €6.29 million) in the Company's technical result €1.1 million (2010: €Nil) of the Group charge arose on investment contracts. Administrative expenses mainly comprise employee benefit expenses which are analysed in Note 11.

Finance costs payable on the subordinated loan at Group level amounting to €0.15 million (2010: €Nil) are included within administrative expenses.

Non-technical account

Administrative expenses in the non-technical profit and loss account represent expenditure after appropriate apportionments are made to the general and long term business technical accounts. They include staff costs, premises costs, depreciation charge, directors' fees, auditors' remuneration, professional fees, marketing and promotional costs, and other general office expenditure.

NOTES TO THE FINANCIAL STATEMENTS

8. INVESTMENT RETURN

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Investment income				
Share of profit of associated undertaking involved in insurance business, net of tax (2011 till July)	**1,644**	3,920	**-**	-
Share of profit of other associated undertaking, net of tax	**-**	229	**-**	-
Dividend income from group undertakings	**-**	-	**721**	6,795
Rent receivable from investment property	**1,737**	504	**406**	504
Interest receivable from loans and receivables				
- other financial assets not at fair value through profit or loss	**2,275**	362	**392**	357
Income from financial assets at fair value through profit or loss				
- dividend income	**1,433**	398	**269**	398
- other net fair value gains	**-**	981	**-**	949
Income from available-for-sale assets	**30**	-	**30**	-
Net fair value gains on investment property	**1,048**	814	**325**	780
Exchange differences	**112**	-	**112**	-
	8,279	7,208	**2,255**	9,783
Investment expenses and charges				
Direct operating expenses arising from investment property that generated rental income	**217**	63	**57**	63
Interest expense for financial liabilities that are not at fair value through profit or loss	**428**	746	**428**	746
Net fair value losses	**968**	-	**360**	-
Impairment of other available-for-sale financial assets (Note 21, 28)	**-**	42	**-**	42
Exchange differences	**-**	168	**-**	168
Other investment expenses	**1,930**	2	**1**	2
	1,930	1,021	**846**	1,021
Total investment income	**6,349**	6,187	**1,409**	8,762
Analysed between:				
Allocated investment return transferred to the general business technical account	**793**	1,667	**793**	1,667
Investment return included in the long term business technical account	**3,791**	253	**128**	253
Other investment income included in the non-technical account	**1,765**	4,267	**488**	6,842
	6,349	6,187	**1,409**	8,762

NOTES TO THE FINANCIAL STATEMENTS

8. INVESTMENT RETURN - CONTINUED

The share of profit of the associated undertaking involved in insurance business reflects the share of profit of MSV Life p.l.c. ("MSV") for the period until 29 July 2011, at which date MSV became a subsidiary of the Group (as further explained in Note 33). Had MSV not been consolidated, the share of profits for the full year would have amounted to €1.77 million.

9. OTHER INCOME

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Other technical income, net of reinsurance				
Investment management fees	**186**	-	**-**	-
Other	**83**	-	**-**	-
	269	-	**-**	-
Other income – non technical				
Management fees	**610**	1,252	**-**	-
Other income	**246**	-	**-**	-
	856	1,252	**-**	-

10. PROFIT BEFORE TAX

The profit before tax is stated after charging/(crediting):

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Employee benefit expense (Note 11)	**4,825**	3,456	**3,547**	2,269
Depreciation/amortisation:				
- intangible assets (Note 16)	**511**	372	**193**	320
- property, plant and equipment (Note 17)	**293**	199	**189**	149
Release of provision for impairment on receivables (Note 25)	**(385)**	(57)	**(385)**	(57)
Impairment of receivables	**352**	-	**352**	-
Write-backs of payables	**(167)**	-	**(167)**	-
Increase in provision for impairment on receivables (Note 25)	**12**	-	**12**	-
Impairment loss on other available-for-sale financial assets (Note 8)	**-**	42	**-**	42
Insurance cover purchased for directors and officers	**38**	7	**25**	7

10. PROFIT BEFORE TAX - CONTINUED

The financial statements include fees charged by the parent company auditor for services rendered during the financial periods ended 31 December 2011 and 2010 relating to entities that are included in the consolidation amounting to:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Annual statutory audit	**116**	63	**55**	55
Other assurance services	**13**	11	**11**	11
Tax advisory and compliance services	**12**	3	**3**	3
Other	**5**	35	**5**	35
	146	112	**74**	104

In addition, fees charged by other auditors (who are also part of the network of member firms of PricewaterhouseCoopers) amounted to:

	Group	
	2011	2010
	€'000	€'000
Annual statutory audit	**50**	-

11. EMPLOYEE BENEFIT EXPENSE

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Salaries	**4,161**	3,280	**2,950**	2,155
Social security costs	**221**	176	**154**	114
Provision for contracted pension obligations (Note 29)	**443**	-	**443**	-
	4,825	3,456	**3,547**	2,269

The average number of persons employed during the year was:

	Group		Company	
	2011	2010	**2011**	2010
Key management personnel	**19**	13	**14**	10
Managerial	**29**	21	**22**	16
Technical	**72**	73	**47**	41
Administrative	**10**	8	**8**	6
	130	115	**91**	73

Following the restructuring which happened in the Group during July 2010 a number of staff members were transferred from a subsidiary company to Middlesea Insurance p.l.c. ('MSI') and MSV Life p.l.c. ('MSV'). The employee number for 2010 under Company represents the average number of staff members employed during the year, hence reflecting half of the staff members transferred. The employee number under Group in 2011 includes *pro-rata* the equivalent number of employees of MSV following 29 July 2011, when MSI acquired *de-facto* control over MSV.

NOTES TO THE FINANCIAL STATEMENTS

12. TAX EXPENSE

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Current tax expense	**498**	557	**532**	1,499
Deferred tax expense/(credit) (Note 22)	**565**	533	**179**	(381)
Income tax expense	**1,063**	1,090	**711**	1,118

The tax on the Group's and Company's profit before tax differs from the theoretical amount that would arise using the basic tax rate as follows:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Profit before tax	**3,110**	6,441	**1,754**	8,857
Tax at 35%	**1,089**	2,254	**614**	3,100
Adjusted for tax effect of:				
Dividends received from untaxed income	**-**	-	**(201)**	(1,434)
Exempt income	**(312)**	(1,595)	**341**	(144)
Unrecognised deferred tax movements	**250**	837	**-**	-
Withholding tax regime on investment property	**98**	(142)	**(72)**	(142)
Other	**(62)**	(264)	**29**	(262)
Income tax expense	**1,063**	1,090	**711**	1,118

13. DIRECTORS' EMOLUMENTS

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Directors' fees	**152**	142	**140**	142

Group Directors' fees include fees payable to the Company's directors from all Group Companies from the date when the companies were recognised as subsidiaries.

The Group's provision and payment in respect of contracted pension obligations in favour of the former Executive Chairman is disclosed in Note 29 of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

14. EARNINGS PER SHARE

Earnings per share are based on the net profit for the year divided by the weighted average number of ordinary shares in issue during the year.

	Group	
	2011	2010
	€'000	€'000
Profit attributable to shareholders	**1,929**	5,351
Number of ordinary shares in issue (Note 27)	**92,000,000**	92,000,000
Earnings per share attributable to shareholders	**2.1c**	5.8c

15. DIVIDENDS

A gross dividend in respect of year ended 31 December 2011 of €0.01 per share amounting to a total dividend of €920,000 (2010: €Nil) is to be proposed by the directors at the forthcoming annual general meeting. This is equivalent to a net dividend of €0.0065 per share amounting to a total net dividend of €598,000. These financial statements do not reflect this dividend.

NOTES TO THE FINANCIAL STATEMENTS

16. INTANGIBLE ASSETS

Group	Value of in-force business (ii) €'000	Computer software €'000	Deferred policy acquisition costs (i) €'000	Total €'000
At 1 January 2010				
Cost or valuation	-	2,873	-	2,873
Accumulated amortisation	-	(2,173)	-	(2,173)
Net book amount	-	700	-	700
Year ended 31 December 2010				
Opening net book amount	-	700	-	700
Additions	-	341	-	341
Disposals	-	(354)	-	(354)
Amortisation charge	-	(372)	-	(372)
Amortisation released on disposal	-	153	-	153
Closing net book amount	-	468	-	468
At 31 December 2010				
Cost or valuation	-	2,860	-	2,860
Accumulated amortisation	-	(2,392)	-	(2,392)
Net book amount	-	**468**	**-**	**468**
Year ended 31 December 2011				
Opening net book amount	-	468	-	468
Assets acquired in a business combination (Note 33)	40,332	1,485	1,202	43,019
Increase in value of in-force business credited to reserves (Note 28)	1,434	-	-	1,434
Additions	-	301	14	315
Amortisation charge	-	(428)	(83)	(511)
Closing net book amount	41,766	1,826	1,133	44,725
At 31 December 2011				
Cost or valuation	41,766	9,886	3,011	54,663
Accumulated amortisation	-	(8,060)	(1,878)	(9,938)
Net book amount	**41,766**	**1,826**	**1,133**	**44,725**

Amortisation of €0.18 million (2010: €Nil) is included in acquisition costs and €0.33 million (2010: €0.37 million) is included in administration expenses.

(i) This intangible asset relates to investment contracts without DPF only.

NOTES TO THE FINANCIAL STATEMENTS

16. INTANGIBLE ASSETS - CONTINUED

(ii) Value of in-force business - assumptions, changes in assumptions and sensitivity

Assumptions

The after tax value of in-force business is determined by the directors on an annual basis, after considering the advice of the Approved Actuary. The value of in-force business depends upon assumptions made regarding future economic and demographic experience. The economic assumptions are internally consistent and reflect the directors' view of economic conditions in the longer term, which are inherently uncertain.

The valuation assumes a spread of 2% (2010: 2%) between the weighted average projected investment return and the risk adjusted discount factor applied of 7.5% (2010: 7.5%). The calculation also assumes lapse rates varying by product from 2% to 10% pa (2010: 2% to 10% pa), and an expense inflation rate of 3.5% pa (2010: 3.5% pa).

Changes in assumptions

Assumptions are reviewed on an annual basis to reflect the development of experience and to improve on the reliability of the estimation process. Realistic and reserving mortality assumptions were adjusted during 2011. Although, the Group still references the table AM80, percentage reductions were applied to that table to better reflect the Company's likely future experience. The effect of this change on the VIF was a decrease of €0.5 million.

Sensitivity analysis

The value of in-force business is sensitive to a large number of assumptions. The following table describes the impact on the value of in-force business arising from a change in the following variables, with all other variables held constant:

Assumption	**Change in variable**	**Impact on value of in-force business €million**
Investment returns	+1.00%	5.5
Investment returns	-1.00%	(5.5)
Risk adjusted discount rate	+1.00%	(2.6)
Risk adjusted discount rate	-1.00%	2.9
Renewal expense	+10.00%	(0.7)
Renewal expense	-10.00%	0.7
Lapse rate	+2.00%	0.9
Lapse rate	-2.00%	(1.4)
Mortality	+15.00%	(0.9)
Mortality	-15.00%	0.9

NOTES TO THE FINANCIAL STATEMENTS

16. INTANGIBLE ASSETS - CONTINUED

Computer software	**Company** €'000
At 1 January 2010	
Cost	2,360
Accumulated amortisation	(1,906)
Net book value	454
Year ended 31 December 2010	
Opening net book amount	454
Additions	323
Amortisation charge	(320)
Closing net book amount	457
At 31 December 2010	
Cost	2,801
Accumulated amortisation	(2,344)
Net book amount	**457**
Year ended 31 December 2011	
Opening net book amount	457
Additions	234
Amortisation charge	(193)
Closing net book amount	498
At 31 December 2011	
Cost	3,035
Accumulated amortisation	(2,537)
Net book amount	**498**

Amortisation expense has been charged in administrative expenses.

NOTES TO THE FINANCIAL STATEMENTS

17. PROPERTY, PLANT AND EQUIPMENT

Group

	Freehold land and buildings €'000	Leasehold improvements €'000	Motor vehicles €'000	Furniture, fittings and equipment €'000	Total €'000
At 1 January 2010					
Cost	498	1,385	94	2,890	4,867
Accumulated depreciation	(12)	(546)	(83)	(2,505)	(3,146)
Net book amount	486	839	11	385	1,721
Year ended 31 December 2010					
Opening net book amount	486	839	11	385	1,721
Additions	-	202	-	170	372
Disposals	-	-	(86)	(44)	(130)
Depreciation charge	(5)	(55)	(1)	(138)	(199)
Depreciation released on disposal	-	-	76	34	110
Closing net book amount	481	986	-	407	1,874
At 31 December 2010					
Cost	498	1,587	8	3,016	5,109
Accumulated depreciation	(17)	(601)	(8)	(2,609)	(3,235)
Net book amount	**481**	**986**	**-**	**407**	**1,874**
Year ended 31 December 2011					
Opening net book amount	481	986	-	407	1,874
Assets acquired in a business combination (Note 33)	399	670	-	704	1,773
Additions	84	242	-	252	578
Transfer from investment properties (Note 18)	1,055	-	-	-	1,055
Disposals	-	(141)	-	(282)	(423)
Depreciation charge	(10)	(77)	-	(206)	(293)
Depreciation released on disposal	-	23	-	200	223
Closing net book amount	2,009	1,703	-	1,075	4,787
At 31 December 2011					
Cost	2,036	2,376	8	4,685	9,105
Accumulated depreciation	(27)	(673)	(8)	(3,610)	(4,318)
Net book amount	**2,009**	**1,703**	**-**	**1,075**	**4,787**

Land and buildings are shown at fair value. The Group's land and buildings were revalued at 31 December 2011 by independent valuers. Valuations were made on the basis of market value.

Depreciation expense has been charged in administrative expenses.

NOTES TO THE FINANCIAL STATEMENTS

17. PROPERTY, PLANT AND EQUIPMENT - CONTINUED

If land and buildings were stated on a historical cost basis, the amounts would be as follows:

	2011 €'000	2010 €'000
At 31 December		
Cost	**1,459**	348
Accumulated depreciation	**(15)**	(10)
Net book amount	**1,444**	338

Company

	Freehold land and buildings €'000	Leasehold improvements €'000	Motor vehicles €'000	Furniture, fittings and equipment €'000	Total €'000
At 1 January 2010					
Cost	69	1,196	89	2,426	3,780
Accumulated depreciation	(3)	(514)	(76)	(2,181)	(2,774)
Net book amount	66	682	13	245	1,006
Year ended 31 December 2010					
Opening net book amount	66	682	13	245	1,006
Additions	-	332	-	217	549
Disposals	-	-	(87)	-	(87)
Depreciation charge	(1)	(52)	-	(96)	(149)
Depreciation released on disposal	-	-	74	-	74
Closing net book amount	65	962	-	366	1,393
At 31 December 2010					
Cost	69	1,528	2	2,643	4,242
Accumulated depreciation	(4)	(566)	(2)	(2,277)	(2,849)
Net book amount	**65**	**962**	**-**	**366**	**1,393**
Year ended 31 December 2011					
Opening net book amount	65	962	-	366	1,393
Additions	-	179	-	130	309
Transfer from investment property	66	-	-	-	66
Depreciation charge	(1)	(56)	-	(132)	(189)
Closing net book amount	130	1,085	-	364	1,579
At 31 December 2011					
Cost	135	1,707	2	2,773	4,617
Accumulated depreciation	(5)	(622)	(2)	(2,409)	(3,038)
Net book amount	**130**	**1,085**	**-**	**364**	**1,579**

Depreciation expense has been charged to administrative expenses.

NOTES TO THE FINANCIAL STATEMENTS

18. INVESTMENT PROPERTY

	Group €'000	Company €'000
At 1 January 2010		
Cost	5,706	6,136
Accumulated fair value gains	3,002	3,031
Net book amount	8,708	9,167
Year ended 31 December 2010		
Opening net book amount	8,708	9,167
Additions	241	241
Disposals	(2,320)	(2,320)
Net fair value gains	777	743
Net book amount	7,406	7,831
At 31 December 2010		
Cost	4,505	4,933
Accumulated fair value gains	2,901	2,898
Net book amount	**7,406**	**7,831**
Year ended 31 December 2011		
Opening net book amount	7,406	7,831
Assets acquired in a business combination (Note 33)	59,053	-
Additions	85	21
Transfer to property, plant and equipment	(1,055)	(66)
Net fair value gains	1,048	325
Net book amount	66,537	8,111
At 31 December 2011		
Cost	42,258	4,937
Accumulated fair value gains	24,279	3,174
Net book amount	**66,537**	**8,111**

The investment properties are valued annually on 31 December at fair value comprising market value by independent professionally qualified valuers.

NOTES TO THE FINANCIAL STATEMENTS

19. INVESTMENT IN SUBSIDIARY UNDERTAKINGS

	Company €'000
Year ended 31 December 2010	
Opening and closing net book amount and cost	**1,212**
Year ended 31 December 2011	
Opening net book amount and cost	1,212
Transfer from investment in associated undertakings (Note 20)	56,002
Closing net book amount	**57,214**
At 31 December 2011	
Deemed cost arising on business combination	**57,214**

The subsidiary undertakings at 31 December are shown below:

Subsidiary undertakings	Registered office	Class of shares held	Percentage of shares held 2011	Percentage of shares held 2010
Euro Globe Holdings Limited	Middle Sea House Floriana	Ordinary shares	100%	100%
Euromed Risk Solutions Limited	Development House Floriana	Ordinary shares	100%	100%
Bee Insurance Management Limited	Development House Floriana	Ordinary shares	100%	100%
MSV Life p.l.c.	Pjazza Papa Giovanni XXIII Floriana	Ordinary shares	50%	-
Church Wharf Properties Limited	Middle Sea House Floriana	Ordinary shares	75%	-

In addition to the subsidiary undertakings above, MSV Life p.l.c. also held the following investments in subsdiary undertakings:

Subsidiary undertakings	Registered office	Class of Shares held	Percentage of shares held 2011	Percentage of shares held 2010
Growth Investment Limited (held indirectly by MSV Life p.l.c.)	Pjazza Papa Giovanni XXIII Floriana	Ordinary shares	50%	-

During 2011, the Company acquired *de-facto* control of MSV Life p.l.c. following a shareholders' agreement as further explained in Note 33. MSV Life p.l.c. had previously been accounted for as an associated undertaking (Note 20). The amount of dividends that can be distributed in cash by the insurance subsidiary is restricted by the solvency requirement imposed by the MFSA regulations.

As a result of this business combination, Church Wharf Properties Limited, which was previously classified as an associated undertaking, also became a subsidiary in view of the fact that the remaining interest in this company is held by MSV Life p.l.c..

NOTES TO THE FINANCIAL STATEMENTS

19. INVESTMENT IN SUBSIDIARY UNDERTAKINGS - CONTINUED

As disclosed in prior years' financial statements, the Company's 100% holding in Progress Assicurazzioni S.p.A. was derecognised in 2009. This was due to Progress Assicurazzioni S.p.A. being put into compulsory administrative liquidation. Subsequent bankruptcy procedures were also initiated. The investment was fully written off in previous years. The Directors are not aware of any developments that could have an impact on the Company's obligations attached to this investment.

20. INVESTMENT IN ASSOCIATED UNDERTAKINGS

	Group €'000	Company €'000
At 1 January 2010		
Cost	19,839	19,839
Accumulated share of associated undertaking's profits and reserves	32,118	-
Accumulated fair value movements	-	32,118
Net book amount	51,957	51,957
Year ended 31 December 2010		
Opening net book amount	51,957	51,957
Additions	1,500	1,500
Share of associated undertaking's profits and movement in reserves	(448)	-
Fair value movements (Note 28)	-	2,016
Closing net book amount	53,009	55,473
At 31 December 2010		
Cost	21,339	21,339
Accumulated share of associated undertaking's profits and reserves	31,670	-
Accumulated fair value movements	-	34,134
Net book amount	**53,009**	**55,473**
Year ended 31 December 2011		
Opening net book amount	53,009	55,473
Assets acquired in a business combination (Note 33)	5,077	-
Additions	147	147
Share of associated undertaking's profits and movement in reserves	513	-
Fair value movements (Note 28)	-	529
Transfer to investment in subsidiary undertakings (Note 33)	(53,538)	(56,002)
Closing net book amount	5,208	147
At 31 December 2011		
Cost	4,481	147
Accumulated fair value movements	727	-
Net book amount	**5,208**	**147**

As further explained in Note 19 and in Note 33, MSV Life p.l.c. and Church Wharf Properties Limited were classified as subsidiaries following the business combination that took place on 29 July 2011. Accordingly the involvement in these undertakings were transferred out from investment in associated undertakings and reclassified accordingly.

20. INVESTMENT IN ASSOCIATED UNDERTAKINGS - CONTINUED

The Group's aggregated assets and liabilities and the share of the results of its associated undertaking, which is unlisted is as follows:

2011	Registered office	Assets €'000	Liabilities €'000	Revenues €'000	Profit €'000	% of interest held
Middlesea Assist Limited	Europa Centre Floriana	300	-	-	-	49%

2010	Registered office	Assets €'000	Liabilities €'000	Revenues €'000	Profit €'000	% of interest held
MSV Life p.l.c.	Pjazza Papa Giovanni XXIII Floriana	1,130,708	1,021,817	147,400	7,841	50%
Church Wharf Properties Limited	Middle Sea House, Floriana	2,329	273	45	457	50%
Total		1,133,037	1,022,090	147,445	8,298	

In addition to the associated undertakings above MSV Life p.l.c. also held the following investments in associated undertakings:

2011	Registered office	Class of shares held	% of interest held
Premium Realty Limited	Middlesea House, Floriana	Ordinary shares	25%
Plaza Centres p.l.c.	The Plaza Commercial Cenre Bisazza Street, Sliema	Ordinary shares	28.36%

The amount of dividends that can be distributed in cash by the insurance associate is restricted by the solvency requirements imposed by the MFSA Regulations.

21. OTHER INVESTMENTS

The investments are summarised by measurement category in the table below.

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Fair value through profit or loss	**865,090**	18,463	**12,202**	17,967
Other available-for-sale	**960**	153	**832**	21
Loans and receivables	**190,513**	22,360	**12,600**	22,360
	1,056,563	40,976	**25,634**	40,348

(a) Investments at fair value through profit or loss

Analysed by type of investment as follows:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Equity securities and units in unit trusts	**239,694**	4,914	**2,979**	4,914
Debt securities – listed fixed interest rate	**536,207**	13,549	**9,223**	13,053
Assets held to cover linked liabilities – collective investment schemes	**89,189**	-	**-**	-
Total investments at fair value through profit or loss	**865,090**	18,463	**12,202**	17,967

Technical provisions for linked liabilities amounted to €89 million as at 31 December 2011. Linked liabilities are included in technical provisions for insurance contracts, investments contracts with DPF and investment contracts without DPF.

At 31 December 2011 and 2010, the Group and Company had no financial commitments in respect to uncalled capital.

Equity securities and units in unit trusts other than those at company level are substantially non-current in nature.

NOTES TO THE FINANCIAL STATEMENTS

21. OTHER INVESTMENTS - CONTINUED

(a) Investments at fair value through profit or loss - continued

The movements for the year are summarised as follows:

	Group €'000	Company €'000
Year ended 31 December 2010		
Opening net book amount	30,182	29,695
Additions	1,811	1,811
Disposals	(13,788)	(13,788)
Net fair value gains	258	249
Closing net book amount	18,463	17,967
Year ended 31 December 2011		
Opening net book amount	18,463	17,967
Assets acquired in a business combination (Note 33)	877,516	-
Additions	138,373	72
Disposals	(158,479)	(4,946)
Net fair value losses	(10,783)	(891)
Closing net book amount	**865,090**	**12,202**

Derivatives and financial instruments amounting to €0.2 million included in the table above, are classified within liabilities in the balance sheet.

(b) Other available-for-sale financial assets

	Group		Company	
	2011 €'000	2010 €'000	**2011 €'000**	2010 €'000
Listed debt securities	**832**	-	**832**	-
Unlisted shares	**128**	153	**-**	21
	960	153	**832**	21

Unlisted shares are classified as non-current. The movements for the year are summarised as follows:

	Group		Company	
	2011 €'000	2010 €'000	**2011 €'000**	2010 €'000
Year ended 31 December				
Opening net book amount	**153**	410	**21**	75
Additions	**809**	-	**809**	-
Disposals	**(21)**	(262)	**(21)**	(12)
Net fair value gains/(losses) (Note 28)	**19**	5	**23**	(42)
Closing net book amount	**960**	153	**832**	21

NOTES TO THE FINANCIAL STATEMENTS

21. OTHER INVESTMENTS - CONTINUED

(c) Loans and receivables

Analysed by type of investment as follows:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Deposits with banks or credit institutions	**178,894**	22,360	**12,600**	22,360
Loans secured on policies	**11,619**	-	**-**	-
	190,513	22,360	**12,600**	22,360

The movements for the year (excluding deposits) are summarised as follows:

	Group Year ended 2011		
	Loans secured on policies €'000	**Reinsurance loan** €'000	**Total** €'000
Total at beginning of year	-	-	-
Assets acquired in a business combination (Note 33)	11,671	1,527	13,198
Disposals (sales and redemptions)	(52)	(1,527)	(1,579)
Total at year-end	11,619	-	11,619

22. DEFERRED INCOME TAX

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Balance at 1 January	**(1,854)**	(2,403)	**(365)**	16
Movements during the year:				
Profit and loss account (Note 12)	**565**	533	**179**	(381)
Other reserves (Note 28)	**(1)**	16	**-**	-
Amounts acquired in a business combination (Note 33)	**7,139**	-	**-**	-
Balance at 31 December – net	**5,849**	(1,854)	**(186)**	(365)

NOTES TO THE FINANCIAL STATEMENTS

22. DEFERRED INCOME TAX - CONTINUED

Deferred income taxes are calculated on all temporary differences under the liability method using a principal tax of 35% (2010: 35%) with the exception of investment property and freehold and other property, for which deferred income taxes may be calculated using a principal tax rate of 12% of the carrying amount (2010: 12%), if appropriate. The year-end balance comprises:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Temporary differences on property, plant and equipment	**181**	(10)	**(8)**	(14)
Temporary differences attributable to unrealised capital losses and exchange gains	**9,745**	542	**565**	523
Temporary differences attributable to unabsorbed tax losses and allowances carried forward	**(4,129)**	(2,307)	**(795)**	(795)
Temporary differences attributable to other provisions	**(46)**	(177)	**(46)**	(177)
Other temporary differences, including impact of non-deductible expenses and different tax rates	**98**	98	**98**	98
Balance at 31 December - net	**5,849**	(1,854)	**(186)**	(365)

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off a current tax asset against a current tax liability. The following amounts determined after appropriate offsetting are shown in the balance sheet:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Deferred tax asset	**(2,351)**	(2,620)	**(1,113)**	(1,113)
Deferred tax liability	**8,200**	766	**927**	748
	5,849	(1,854)	**(186)**	(365)

The deferred income tax assets and liabilities are, principally, recoverable after more than 12 months.

Deferred income tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefit through future taxable profits is probable.

The Group and Company have unutilsed capital losses of €1.60 million (2010: €3.55 million), which give rise to a deferred tax asset of €0.56 million (2010: €1.24 million) that has not been recognised in these financial statements. The Group also has unutilised trading losses of €5.61 million (2010: €2.4 million), giving rise to a further deferred tax asset of €1.96 million (2010: €0.84 million) which has not been recognised in these financial statements. The deferred tax assets are re-examined on an annual basis.

NOTES TO THE FINANCIAL STATEMENTS

23. INSURANCE LIABILITIES AND REINSURANCE ASSETS

Technical provisions – insurance contracts and investment contracts with DPF

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Gross				
Short-term insurance contracts – general business				
- claims outstanding	**40,104**	39,678	**40,104**	39,678
- provision for unearned premiums and unexpired risks	**13,994**	15,037	**13,994**	15,037
Group life insurance contracts				
- claims outstanding	**77**	134	**77**	134
- long term business provision	**638**	682	**638**	682
Long term contracts				
- individual life insurance contracts	**388,693**	-	**-**	-
- investment contracts with DPF	**585,748**	-	**-**	-
Total technical provisions, gross	**1,029,254**	55,531	**54,813**	55,531
Recoverable from reinsurers				
Short-term insurance contracts				
- claims outstanding	**10,892**	9,832	**10,892**	9,832
- provision for unearned premiums and unexpired risks	**5,011**	5,215	**5,011**	5,215
Group life insurance contracts				
- claims outstanding	**32**	41	**32**	41
- long term business provision	**273**	269	**273**	269
Long term contracts				
- individual life insurance contracts	**228**	-	**-**	-
Total reinsurers' share of insurance liabilities	**16,436**	15,357	**16,208**	15,357
Net				
Short-term insurance contracts				
- claims outstanding	**29,212**	29,846	**29,212**	29,846
- provision for unearned premiums and unexpired risks	**8,983**	9,822	**8,983**	9,822
Group life insurance contracts				
- claims outstanding	**45**	93	**45**	93
- long term business provision	**365**	413	**365**	413
Long term contracts				
- individual life insurance contracts	**388,465**	-	**-**	-
- investment contracts with DPF	**585,748**	-	**-**	-
Total technical provisions, net	**1,012,818**	40,174	**38,605**	40,174

NOTES TO THE FINANCIAL STATEMENTS

23. INSURANCE LIABILITIES AND REINSURANCE ASSETS - CONTINUED

Technical provisions in relation to short term insurance contracts are classified as current liabilities. Technical provisions in relation to long term business are substantially non-current.

(a) Short-term insurance contracts – claims outstanding

The gross claims reported are net of expected recoveries from salvage and subrogation. The amounts for salvage and subrogation at the end of 2011 and 2010 are not material.

The technical provisions are largely based on case-by-case estimates supplemented with additional provisions for IBNR and unexpired risks in those instances where the ultimate cost determined by estimation techniques is higher.

The development tables below give an indication of the time it takes to settle certain claims. This is attributable to certain classes of business taking several years to develop and is also due to the length of time it takes certain classes to be resolved in court.

The top half of the table below illustrates how the Company's estimate of total claims incurred for each accident year has changed at successive year-ends on a net basis. The bottom half of the table reconciles the cumulative claims to the amount appearing in the balance sheet on a net basis. The accident-year basis is considered to be the most appropriate for the general business written by the Company.

Company

Accident year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total
	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000
Estimate of the ultimate claims costs:												
- at end of accident year	9,548	15,110	15,134	14,335	13,196	13,470	14,423	15,458	15,248	17,111	15,972	
- one year later	9,316	15,660	14,165	14,147	13,257	12,783	13,517	15,661	15,319	15,871		
- two years later	9,448	14,880	13,284	13,174	11,729	11,569	12,674	13,415	13,367			
- three years later	9,370	14,262	12,543	12,170	11,212	10,887	11,582	12,781				
- four years later	9,046	14,147	12,378	11,850	10,871	10,030	11,411					
- five years later	8,923	13,842	11,798	11,445	10,447	9,935						
- six years later	8,851	13,796	11,684	10,590	10,251							
- seven years later	8,833	13,646	11,392	10,421								
- eight years later	8,739	13,661	11,284									
- nine years later	9,029	13,522										
- ten years later	8,297											
Current estimates of cumulative claims	8,297	13,522	11,284	10,421	10,251	9,935	11,411	12,781	13,367	15,871	15,972	133,112
Cumulative payments to date	(7,745)	(12,995)	(10,925)	(9,386)	(9,620)	(8,798)	(10,187)	(11,040)	(10,713)	(10,338)	(7,023)	(108,770)
Liability recognised in the balance sheet	552	527	359	1,035	631	1,137	1,224	1,741	2,654	5,533	8,949	24,342
Liability in respect of prior years												4,870
Total reserve included in the balance sheet												29,212

23. INSURANCE LIABILITIES AND REINSURANCE ASSETS - CONTINUED

(a) Short-term insurance contracts – claims outstanding - continued

The Company continues to benefit from reinsurance programmes that were purchased in prior years and includes proportional cover supplemented by excess of loss reinsurance cover. The reinsurers' share of claims liabilities is estimated net of the provision for known and expected incidents of insolvency of reinsurers.

Movements in claims and loss adjustments expenses.

	Group and Company Year ended 2010		
	Gross €'000	Reinsurance €'000	Net €'000
Total at beginning of year	39,749	(9,052)	30,697
Claims settled during the year	(18,036)	5,336	(12,700)
Increase/(decrease) in liabilities			
- arising from current year claims	23,231	(6,121)	17,110
- arising from prior year claims	(5,266)	5	(5,261)
At end of year	39,678	(9,832)	29,846

	Group and Company Year ended 2011		
	Gross €'000	Reinsurance €'000	Net €'000
Total at beginning of year	39,678	(9,832)	29,846
Claims settled during the year	(16,544)	4,996	(11,548)
Increase/(decrease) in liabilities			
- arising from current year claims	22,653	(6,681)	15,972
- arising from prior year claims	(5,683)	625	(5,058)
At end of year	40,104	(10,892)	29,212

NOTES TO THE FINANCIAL STATEMENTS

23. INSURANCE LIABILITIES AND REINSURANCE ASSETS - CONTINUED

(a) Short-term insurance contracts – claims outstanding - continued

Movements in claims and loss adjustments expenses - continued

The Group continuously monitors closely the development in insurance liabilities in order to ascertain the adequacy of its claims reserves. Movements in reserves in respect of claims occurring in previous years arise when these claims are actually settled and/or when reserves are revised to reflect new information that emerges.

The Company registered a gross favorable run-off of €5.68 million (2010: €5.27 million). After the effect of reinsurance, this amounts to €5.06 million (2010: €5.26 million). This run-off arose principally from a favorable development on claims in the motor and liability classes of direct general business of insurance. This is attributable, *inter alia*, to savings made during the claims handling process.

(b) Short-term insurance contracts - provision for unearned premiums and unexpired risks

The movements for the year are summarised as follows:

	Group and Company Year ended 2010		
	Gross €'000	Reinsurance €'000	Net €'000
At beginning of year	12,970	(4,580)	8,390
Transfer from insurance payables	1,130	-	1,130
Net charge/(credit) to profit and loss	937	(635)	302
At end of year	15,037	(5,215)	9,822

	Group and Company Year ended 2011		
	Gross €'000	Reinsurance €'000	Net €'000
At beginning of year	15,037	(5,215)	9,822
Net (credit)/charge to profit and loss	(1,043)	204	(839)
At end of year	13,994	(5,011)	8,983

The balance at 31 December 2011 includes a provision for unexpired risks of €0.59 million (2010: €0.65 million).

NOTES TO THE FINANCIAL STATEMENTS

23. INSURANCE LIABILITIES AND REINSURANCE ASSETS - CONTINUED

(c) Group Life insurance contracts

Claims outstanding

Movement in claims outstanding is summarised as follows:

	Group and Company Year ended 2010		
	Gross €'000	Reinsurance €'000	Net €'000
At beginning of year	133	(62)	71
Claims settled during the year	(603)	407	(196)
Increase/(decrease) in liabilities	338	(143)	195
At end of year	134	(41)	93

	Group and Company Year ended 2011		
	Gross €'000	Reinsurance €'000	Net €'000
At beginning of year	134	(41)	93
Claims settled during the year	(395)	152	(243)
Increase/(decrease) in liabilities	338	(143)	195
At end of year	77	(32)	45

Long term business provision

The balance on the long term business provision has been certified by the Company's appointed actuary as being sufficient to meet liabilities at 31 December 2011. The net assets representing this long term business provision, which are included under the respective headings in the Group's overall balance sheet, are as follows:

	2011 €'000	2010 €'000
Investments	**3,866**	3,392
Insurance and other receivables	**942**	726
Cash at bank and in hand	**168**	523
Claims outstanding	**(45)**	(93)
Insurance and other payables	**(4,566)**	(4,135)
Long term business provision, net of reinsurance	**365**	413

NOTES TO THE FINANCIAL STATEMENTS

23. INSURANCE LIABILITIES AND REINSURANCE ASSETS - CONTINUED

(d) Long term business – Individual Insurance life contracts and investment contracts with DPF

Individual life insurance contracts

	2011
	€'000
Gross technical provisions	
- claims outstanding	**766**
- long term business provision	**387,927**
	388,693
Reinsurers' share of technical provisions	
- claims outstanding	**228**
- long term business provision	**-**
	228
Net technical provisions	
- claims outstanding	**538**
- long term business provision	**387,927**
	388,465

The movements for the year are summarised as follows:

	Group Year ended 2011		
	Gross €'000	Reinsurance €'000	Net €'000
Year ended 31 December			
At beginning of year	-	-	-
Liabilities acquired in a business combination (Note 33)	387,017	(3,195)	383,822
Charge to the profit and loss account	1,676	2,967	4,643
At end of year	388,693	(228)	388,465

The above liabilities are substantially non-current in nature.

NOTES TO THE FINANCIAL STATEMENTS

23. INSURANCE LIABILITIES AND REINSURANCE ASSETS - CONTINUED

(d) Long term business – Individual Insurance life contracts and investment contracts with DPF - continued

	Group 2011 €'000
Investment contracts with DPF (gross and net)	
- claims outstanding	**900**
- long term business provision	**584,848**
	585,748

The movements for the year are summarised as follows:

	2011 €'000
Year ended 31 December	
At beginning of year	**-**
Liabilities acquired in a business combination (Note 33)	**575,418**
Charge to the profit and loss account	**10,330**
At end of year	**585,748**

The above liabilities are substantially non-current in nature.

Long term contracts – assumptions, changes in assumptions and sensitivity

The technical provisions in respect of long term contracts and linked long term contracts are subject to an annual statutory valuation undertaken by the Approved Actuary based on data and information provided by the Group. The technical provisions are calculated in accordance with the Insurance Business (Insurers' Assets and Liabilities) Regulations, 2007 ('the Regulations').

Different principles and valuation methodologies are adopted depending on the type and generation of products. The key assumptions used in determining the technical provisions in respect of insurance contracts and investment contracts with DPF are described below.

(i) Assumptions

Rate of future investment return

The rate of future investment return (valuation interest rate) is calculated in accordance with the Regulations. The calculation of the rate of future investment return is based on a prudent assessment of the yields generated by the long term business assets, which does not include any allowance for capital growth. The weighted average yield is further reduced by certain risk adjustments.

23. INSURANCE LIABILITIES AND REINSURANCE ASSETS - CONTINUED

(d) *Long term business – Individual Insurance life contracts and investment contracts with DPF* - continued

(i) *Assumptions* - continued

Bonus rates

The expected rates of reversionary and terminal bonuses are determined by the Board in consultation with the Approved Actuary. Different bonus rates are declared on different generations of contracts depending on the type of product, cost structure, past investment performance and premium rates. Different bonuses are declared to reduce the element of cross-subsidy of products with different characteristics, and to maintain equity between different generations of contract holders. The levels of reversionary bonus rates are effected by measures taken to provide resilience to market conditions, and to provide for future payments of terminal bonuses. These measures are not intended, over the long term, to be a source of profit or loss.

Policy maintenance expenses

The per policy maintenance expense has been determined by reference to the Group's cost base.

Minimum reserve

The minimum reserve on each policy is equal to the current surrender value.

Mortality

The Group continues to make reference to AM80 tables.

(ii) *Changes in assumptions*

In accordance with normal practice, investment return assumptions were revised to reflect market movements during the year. Revisions were also effected to policy expense expectations. The combined impact of these changes in assumptions has been charged against the technical result for the year.

Reserving mortality assumptions were adjusted by MSV Life p.l.c. ("MSV") during 2011. Although, reference is still made to the table AM80, percentage reductions were applied to that table to better reflect MSV's likely future experience. The effect of this change on the technical provisions was a decrease of €2.2 million at MSV level. The impact on Group results is included in the share of associate's results and amounted to €0.72 million, net of tax.

NOTES TO THE FINANCIAL STATEMENTS

23. INSURANCE LIABILITIES AND REINSURANCE ASSETS - CONTINUED

(d) Long term business – Individual Insurance life contracts and investment contracts with DPF - continued

(iii) Sensitivity analysis

The directors have considered the sensitivity of the key variables underlying the liability for long term contracts. The most sensitive assumption is the rate of future investment return that will be driven by market forces. Sensitivity analysis for interest rate risk and equity price risk has been disclosed in Note 4. The Insurance Regulations ensure a consistent and prudent derivation of this key estimate as described above. The Group's bonus policy is also influenced by market conditions, which mitigates the impact of movements in the valuation interest rate on the long term liability and the profit and loss account.

The Group's reserving policy considers market conditions over the longer term through prudent assumptions of future investment returns combined with a consistent view of future bonuses.

Technical Provisions – Investment contracts without DPF

	2011 **€'000**
Long term business provision	**60,205**
Claims outstanding	**133**
	60,338

The above liability is considered to be substantially non-current in nature.

24. DEFERRED ACQUISITION COSTS – SHORT TERM INSURANCE CONTRACTS

	Group		**Company**	
	2011 **€'000**	2010 €'000	**2011** **€'000**	2010 €'000
Year ended 31 December				
Opening net book amount	**2,960**	2,673	**2,960**	2,673
Net amount charged to the profit and loss	**(62)**	287	**(62)**	287
Closing net book amount	**2,898**	2,960	**2,898**	2,960

Deferred acquisition costs are all classified as current assets.

NOTES TO THE FINANCIAL STATEMENTS

25. INSURANCE AND OTHER RECEIVABLES

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Receivables arising from direct insurance operations:				
- due from policyholders	**66**	137	**66**	137
- due from agents, brokers and intermediaries	**7,532**	8,597	**7,532**	8,597
- due from reinsurers	**534**	676	**534**	676
Receivables arising from reinsurance operations:				
- due from reinsurers	**153**	103	**153**	103
Deposits with ceding undertakings	**147**	147	**147**	147
Other loans and receivables:				
- prepayments	**1,187**	517	**727**	478
- accrued interest and rent	**12,166**	314	**159**	305
- receivables from group undertakings	**-**	-	**45**	5
- receivables from associated undertakings	**66**	142	**66**	104
- other receivables	**107**	166	**-**	-
Provision for impairment of receivables	**(123)**	(496)	**(123)**	(496)
	21,835	10,303	**9,306**	10,056
Current portion	**21,835**	10,303	**9,306**	10,056

Balances due from group undertakings and other receivables are unsecured, non-interest bearing and have no fixed date of repayment.

Movements in the provision for impairment of receivables are as follows:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Balance as at 1 January	**496**	553	**496**	553
Provision for impairment	**12**	-	**12**	-
Release of provision for impairment during the year	**(385)**	(57)	**(385)**	(57)
Balance as at 31 December	**123**	496	**123**	496

NOTES TO THE FINANCIAL STATEMENTS

26. CASH AND CASH EQUIVALENTS

For the purpose of the statements of cash flows, the year-end cash and cash equivalents comprise the following:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Cash at bank and in hand	**7,380**	2,734	**952**	1,875

27. SHARE CAPITAL

	Group and Company	
	2011	2010
	€'000	€'000
Authorised		
150 million ordinary shares of €0.21 each (2010: 150 million ordinary shares of €0.60 each)	**31,500**	90,000
Issued and fully paid		
92 million ordinary shares of €0.21 each (2010: 92 million ordinary shares of €0.60 each)	**19,320**	55,200

During the Extraordinary General meeting held on 16 March 2010, the authorised share capital was increased to 150,000,000 Ordinary shares at a nominal value of €0.60 each.

During the Annual General Meeting held on the 3 May 2011, the shareholders approved the offsetting of the Company's accumulated losses, partly through the reduction in the nominal value of each of its ordinary shares from a nominal value of €0.60 to €0.21, amounting to a reduction of the Issued Share Capital from €55,200,000 (divided into 92 million ordinary shares of €0.60 each) to €19,320,000 (divided into 92 million ordinary shares of €0.21 each).

In line with the aforesaid reduction the authorised share capital was reduced from €90,000,000 (divided into 150 million ordinary shares of €0.60 each) to €31,500,000 (divided into 150 million ordinary shares of €0.21 each).

During the Annual General Meeting held on 3 May 2011, the shareholders further approved the offsetting of the Company's remaining accumulated losses through a transfer of €1.53 million from the Share Premium Reserve.

NOTES TO THE FINANCIAL STATEMENTS

28. OTHER RESERVES

Group

	Value of in-force business €'000	Available-for-sale investments €'000	Total €'000
Balance at 1 January 2010	20,364	4	20,368
Fair value movements – gross (Note 21)	-	47	47
Fair value movements – tax (Note 22)	-	(16)	(16)
Share of increase in value of in-force business of associated undertaking	903	-	903
Balance at 31 December 2010	21,267	35	21,302
Balance at 1 January 2011	21,267	35	21,302
Fair value movements – gross (Note 21)	-	19	19
Fair value movements – tax (Note 22)	-	1	1
Share of increase in value of in-force business of subsidiary undertaking	717	-	717
Share of decrease in value of in-force business of associated undertaking	(1,100)	-	(1,100)
Balance at 31 December 2011	20,884	55	20,939

The above reserves are not distributable reserves.

Company

	Investment in subsidiary undertaking €'000	Investment in associate undertaking €'000	Available-for-sale investments €'000	Total €'000
Balance at 1 January 2010	-	32,118	-	32,118
Fair value movements – gross (Note 20)	-	2,016	-	2,016
Balance at 31 December 2010	-	34,134	-	34,134
Balance at 1 January 2011	-	34,134	-	34,134
Fair value movements – gross (Note 20 and 21)	-	529	23	552
Reclassification of associate to subsidiary undertaking	34,663	(34,663)	-	-
Balance at 31 December 2011	34,663	-	23	34,686

The above reserves are not distributable reserves.

NOTES TO THE FINANCIAL STATEMENTS

29. PROVISIONS FOR OTHER LIABILITIES AND CHARGES

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Provision for contracted pension obligations	**1,199**	833	**1,199**	833
Balance at 31 December	**1,199**	833	**1,199**	833

Provision for contracted pension obligations

	Group and Company	
	2011	2010
	€'000	€'000
At 1 January	**833**	902
Interest cost	**56**	-
Actuarial losses	**387**	-
Payments	**(77)**	(69)
Balance at 31 December	**1,199**	833

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Current	**79**	75	**79**	75
Non-current	**1,120**	758	**1,120**	758
Total	**1,199**	833	**1,199**	833

The Group operates a defined benefit plan in favour of a former Executive Chairman. The pension plan defines an amount of pension benefit that he receives on retirement. The liability recognised in the balance sheet is the present value of the obligation determined by discounting estimated future cash outflows.

The key assumptions underlying this calculation include estimated life expectancy (based on published mortality rates), estimated inflation rates (based on publicly available information) and a discount rate of 4.83% reflecting the term of the liability.

30. BORROWINGS

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Bank loans	**8,500**	13,285	**2,500**	13,285

The carrying amounts of borrowings approximate their fair value.

NOTES TO THE FINANCIAL STATEMENTS

31. INSURANCE AND OTHER PAYABLES

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Deposits received from reinsurers	**165**	4,616	**165**	4,616
Creditors arising out of direct insurance operations	**6,696**	3,114	**3,562**	3,114
Creditors arising out of reinsurance operations	**245**	363	**245**	363
Amounts owed to associated undertaking	**-**	16	**-**	15
Amounts owed to group undertakings	**-**	-	**1,001**	1,274
Social security and other tax payables	**1,038**	411	**386**	408
Accruals	**3,077**	2,400	**1,835**	2,282
Deferred income	**2,204**	1,754	**1,706**	1,754
	13,425	12,674	**8,900**	13,826
Current	**13,214**	12,674	**8,900**	13,826
Non-current	**211**	-	**-**	-
	13,425	12,674	**8,900**	13,826

32. CASH GENERATED FROM/(USED IN) OPERATIONS

Reconciliation of profit before tax to cash generated from/(used in) operations:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Profit before tax	**3,110**	6,441	**1,754**	8,857
Adjusted for:				
Depreciation (Note 17)	**293**	199	**189**	149
Impairment charges	**352**	-	**352**	-
Release of provision for impairment of receivables (Note 25)	**(373)**	(57)	**(373)**	(57)
Other provision for liabilities and charges (Note 29)	**366**	(69)	**366**	(69)
Amortisation (Note 16)	**511**	372	**193**	320
Adjustments relating to investment return	**(2,905)**	(1,913)	**(942)**	(8,489)
Loss/(profit) on sale of property, plant and equipment	**85**	(1)	**-**	(1)
Movements in:				
Insurance and other receivables	**1,243**	39	**600**	154
Deferred acquisition costs (Note 24)	**62**	(287)	**62**	(287)
Reinsurers' share of technical provisions	**2,115**	(1,564)	**(851)**	(1,564)
Technical provisions	**6,792**	2,271	**(718)**	2,271
Insurance and other payables	**(6,473)**	(2,415)	**(4,777)**	(2,199)
Cash generated from/(used in) operations	**5,178**	3,016	**(4,145)**	(915)

Non-cash transactions

The principal non-cash transactions comprised dividends receivable from group and associated undertakings as consideration for the additional investment in these companies in addition to the de-recognition of subsidiary undertakings.

NOTES TO THE FINANCIAL STATEMENTS

33. BUSINESS COMBINATION

On 29 July 2011, Middlesea Insurance p.l.c. acquired *de-facto* control over MSV Life p.l.c. ("MSV") without purchasing a further interest in the acquiree. Control was acquired by virtue of a shareholders' agreement that was signed as a consequence of the changed shareholding in Middlesea Insurance p.l.c. during the year, which resulted in Mapfre Internacional S.A. acquiring a controlling interest in the Company.

MSV, which was previously classified as an associated undertaking, is licensed under the Insurance Business Act, 1998 to transact long term insurance business and under the Investment Services Act, 1994 to provide investment services.

Middlesea Insurance p.l.c. held 50% of the shares of MSV before and after this business combination. The fair value of MSV at the time that control was acquired was not deemed to be significantly different to its net asset value. As in prior years, the fair value was determined by reference to MSV's embedded value that is principally made up of the net assets of MSV and the value of its in-force business, which is also accounted for in MSV's statement of financial position.

As a result of this business combination, Church Wharf Properties Limited also became a subsidiary, in view of the fact that the remaining 50% interest in this entity is held by MSV.

The table below summarises the fair value/carrying amounts of the assets and liabilities recognised and the non-controlling interest at the acquisition date.

Recognised amounts of identifiable assets acquired and liabilities assumed

	As at 29 July 2011 €'000
Assets	
Intangible assets	43,019
Property, plant and equipment	1,773
Investment property	59,053
Investment in associated undertaking	5,077
Other investments	1,014,098
Reinsurers' share of technical provisions	3,195
Insurance and other receivables	11,967
Income tax receivable	3,829
Cash and cash equivalents	14,329
Liabilities	
Deferred income tax	(7,139)
Technical provisions	(1,027,269)
Borrowings	(6,000)
Insurance and other payables	(7,404)
Total identifiable net assets	108,528
Non-controlling interest	(54,990)
Total	53,538

NOTES TO THE FINANCIAL STATEMENTS

33. BUSINESS COMBINATION - CONTINUED

These amounts also represent the fair value of the interest held by the acquirer immediately before the acquisition date and have been transferred accordingly from investments in associates to investments in subsidiary undertakings.

The premium written included in the consolidated statement of comprehensive income since 29 July 2011 contributed by MSV was €45.30 million. MSV and Church Wharf Properties Limited also contributed to profits of €0.24 million over the same period.

Had MSV and Church Wharf Properties Limited been consolidated from 1 January 2011, the consolidated statement of income would show premium written of €112.04 million and profits of €3.53 million.

34. COMMITMENTS

Capital commitments

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Authorised and not contracted for				
- property, plant and equipment	**948**	549	**270**	549
- intangible assets	**2,596**	401	**978**	401

Operating lease commitments – where the company is a lessor

The Group and the Company lease out certain premises under operating leases. The future minimum lease payments receivable under non-cancellable operating leases are as follows:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Not later than 1 year	**2,886**	338	**190**	338
Later than 1 year and not later than 5 years	**3,942**	409	**48**	409
Later than 5 years	**203**	-	**-**	-
	7,031	747	**238**	747

Rental income from operating leases recognised in profit or loss during the year is disclosed in Note 8.

Investment property includes properties valued at €4.47 million (2010: €Nil) on which the lessees have an option to buy these properties at a pre-determined price and within a pre-determined time. The fair value of these properties does not exceed the pre-determined option price.

NOTES TO THE FINANCIAL STATEMENTS

35. CONTINGENCIES

The Company has given guarantees to third parties amounting to €0.17 million (2010: €1.47 million) not arising under contracts of insurance.

36. RELATED PARTY TRANSACTIONS

In the normal course of business, the Group enters into various transactions with related parties. Related parties are defined as those that have an ability to control or exercise significant influence over the other party in making financial and operational decisions. These include directors and shareholders who hold a substantial amount of the votes able to cast at general meetings.

Relevant particulars of related party transactions are as follows:

(a) Sales of insurance contracts and other services	**2011 €'000**	2010 €'000
Sale of insurance contracts		
- subsidiaries	**160**	16
- associates	**-**	131
- shareholders represented on the Board	**1,288**	1,652
Claim recoveries from shareholders represented on the board	**2,664**	4,544
Reimbursement of expenses for back-office services provided		
- subsidiaries (after business combination)	**63**	-
- associate (before business combination)	**88**	610
- shareholders represented on the Board	**22**	42
Investment income		
- subsidiaries (dividends/interest receivable)	**698**	350
- associate (dividends)	**23**	6,445
- shareholders represented on the Board (dividends/interest receivable)	**612**	233
Rent receivable from subsidiary/associate	**40**	13

(b) Purchases of products and services	**2011 €'000**	2010 €'000
Reinsurance premium ceded to shareholders (represented on the Board) net of commissions	**4,887**	7,238
Acquisition costs payable to intermediaries where directors of the Company are directors or shareholders in companies that act as insurance agents or intermediaries	**1,122**	236
Reimbursement of expenses payable for back-office services		
- subsidiaries	**-**	631
Interest payable on borrowings		
- shareholder represented on the Board (acting as banker)	**491**	528
Rent payable to subsidiary/associate	**6**	27

36. RELATED PARTY TRANSACTIONS - CONTINUED

During the year, the Company acquired intangible assets amounting to €4k (2010: €17k) and property, plant and equipment amounting to €217k from a subsidiary in 2010. The Group transferred investment property for €2.36 million, property, plant and equipment for €10k and intangible assets €200k in 2010 to one of its associates.

During 2010 the Company paid a subordinated loan on behalf of a group undertaking as disclosed in Note 29.

Key management personnel during 2011 and 2010 comprised the President & Chief Executive Officer, Chief Executive Officers, Vice Presidents, General Manager, Financial Controller, Chief Officers and Chief Underwriters. Total remuneration paid by the Group to key management personnel as from 29 July 2011, amounted to €1.20 million (Company: €0.85 million). Corresponding figures for 2010 were €0.73 million and €0.48 million. The 2010 Company figure reflects the equivalent of a half-year remuneration payable to key management personnel who was transferred to the parent company from a subsidiary as a consequence of the Group restructuring which took place on 1 July 2010.

Year-end balances arising from the above transactions:

	Group		Company	
	2011	2010	**2011**	2010
	€'000	€'000	**€'000**	€'000
Debtors arising out of direct insurance operations	**7**	83	**7**	83
Creditors arising out of direct insurance operations	**442**	2,606	**442**	2,606
Amounts owed by subsidiary undertakings	**-**	-	**45**	5
Amounts owed to subsidiary undertaking	**-**	-	**1,001**	1,274
Amount owed by associated undertaking	**66**	142	**66**	104
Amounts owed to associated undertaking	**-**	16	**-**	15
Reinsurers share of technical provisions	**1,447**	5,880	**1,447**	5,880
Investments with related parties	**134,313**	12,199	**4,731**	12,199
Provision for contracted pension obligations (key management personnel)	**1,199**	833	**1,199**	833
Accruals and other liabilities (key management personnel)	**22**	-	**22**	-

All balances above have arisen in the course of the Group's normal operations.

37. STATUTORY INFORMATION

Middlesea Insurance p.l.c. is a public limited company and is incorporated in Malta.

The Group is 54.56% owned by Mapfre Internacional (the "immediate parent"), a company registered in Spain, the registered office of which is situated at Paseo de Recoletos 25, E-28004, Madrid.

The Group's ultimate parent is Mapfre S.A., the registered office of which is situated at Paseo de Recoletos 25, E-28004, Madrid, Spain.

Middlesea Insurance p.l.c.

A Member of the MAPFRE Group

www.middlesea.com

Middle Sea House | Floriana FRN 1442 | Malta