Direct Line | Churchill | Privilege | Green Flag | NIG | Brand Partners

Direct Line Group

Price Range Prospectus

28 September 2012

This document comprises a prospectus (the "**Prospectus**") relating to Direct Line Insurance Group plc (the "**Company**") prepared in accordance with the Prospectus Rules of the Financial Services Authority (the "**FSA**") made under section 73A of the Financial Services and Markets Act 2000 (the "**FSMA**"). The Prospectus has been filed with the FSA and has been made available to the public in accordance with the Prospectus Rules.

Application has been made to the FSA for all of the Ordinary Shares of the Company, issued and to be issued, to be admitted to the premium listing segment of the Official List maintained by the FSA and to the London Stock Exchange for such Ordinary Shares to be admitted to trading on the London Stock Exchange's main market for listed securities. Conditional dealings in the Ordinary Shares are expected to commence at 8.00 a.m. on 11 October 2012. It is expected that admission to listing and trading will become effective and that unconditional dealings will commence at 8.00 a.m. on 16 October 2012. **All dealings in Ordinary Shares prior to the commencement of unconditional dealings will be on a "when issued" basis and of no effect if Admission does not take place and will be at the sole risk of the parties concerned. No application has been, or is currently intended to be, made for the Ordinary Shares to be admitted to listing or trading on any other stock exchange.**

The Directors of the Company, whose names appear on pages 96-97 of this Prospectus, and the Company accept responsibility for the information contained in this Prospectus. To the best of the knowledge of the Directors and the Company (who have taken all reasonable care to ensure that such is the case), the information contained in this Prospectus is in accordance with the facts and contains no omission likely to affect its import.

Investors are advised to examine all the risks that might be relevant in connection with an investment in the Ordinary Shares. Investors should read the entire document, and in particular, Part II: Risk Factors for a discussion of certain factors that should be considered in connection with an investment in the Ordinary Shares.

DIRECT LINE INSURANCE GROUP PLC

(Incorporated under the Companies Acts 1985 to 2006 and registered in England and Wales with registered number 02280426)

Offer of up to 500,000,000 Ordinary Shares of 10p each
at an Offer Price expected to be between 160p and 195p per Ordinary Share
and admission to the Premium Listing Segment of the Official List and to trading on the London Stock Exchange

Joint Sponsors

Goldman Sachs International | **Morgan Stanley**

Joint Global Coordinators

Goldman Sachs International | **Morgan Stanley**

Joint Bookrunners

Goldman Sachs International | **Morgan Stanley** | **UBS Investment Bank**

Joint Lead Managers

Citigroup | **HSBC** | **B of A Merrill Lynch**

Co-Managers

BNP PARIBAS | **Commerzbank** | **Investec Bank plc** | **Keefe, Bruyette & Woods** | **RBC Capital Markets**

Underwriter and Coordinator of the Intermediaries Offer

Barclays

ISSUED ORDINARY SHARE CAPITAL IMMEDIATELY FOLLOWING ADMISSION

Ordinary Shares of	Number	Nominal Value of Issued Ordinary Shares
10p each	1,500,000,000	£150,000,000

The Price Range is indicative only, it may change during the course of the Offer and the Offer Price may be set within, above or below the Price Range. The amount to be raised and the number of Ordinary Shares to be sold may be increased or decreased during the course of the Offer. A number of factors will be considered in determining the Offer Price, the amount raised in the Offer and the basis of allocation, including the level and nature of demand for the Ordinary Shares during the book-building process, prevailing market conditions and the objective of establishing an orderly after-market in the Ordinary Shares. Unless required to do so by law or regulation, the Company does not envisage publishing any supplementary prospectus or a pricing statement, as the case may be, until announcement of the Offer Price. A pricing statement containing the Offer Price, confirming the number of Ordinary Shares which are the subject of the Offer and containing any other outstanding information (the "**Pricing Statement**") is expected to be published on or about 11 October 2012.

The Institutional Banks, each of which is authorised and regulated by the FSA, are acting exclusively for the Selling Shareholder and the Company and no one else in connection with the Offer. They will not regard any other person (whether or not a recipient of this Prospectus) as their respective clients in relation to the Offer and will not be responsible to anyone other than the Company and the Selling Shareholder for providing the protections afforded to their respective clients nor for giving advice in relation to the Offer, Admission or any other matter referred to in this Prospectus.

Barclays, which is authorised and regulated by the FSA, is acting exclusively for the Selling Shareholder and the Company and no one else in connection with the Intermediaries Offer. Barclays will not regard any other person (whether or not a recipient of this document) as its client in relation to the Intermediaries Offer and will not be responsible to anyone other than the Selling Shareholder and the Company for providing the protection afforded to its clients nor for giving advice in relation to the Intermediaries Offer, Admission or any transaction or arrangement referred to herein.

None of the Institutional Banks is acting as underwriter of the Intermediaries Offer. Barclays is not acting as sponsor, coordinator, bookrunner, underwriter, manager or arranger of or in connection with the Institutional Offer.

Apart from the responsibilities and liabilities, if any, which may be imposed on any of the Banks by the FSMA or the regulatory regime established thereunder, or under the regulatory regime of any jurisdiction where the exclusion of liability under the relevant regulatory regime would be illegal, void or unenforceable, none of the Banks accepts any responsibility whatsoever for, or makes any representation or warranty, express or implied, as to the contents of this document or for any other statement made or purported to be made by it, or on its behalf, in connection with the Company, the Ordinary Shares or the Offer and nothing in this Prospectus will be relied upon as a promise or representation in this respect, whether or not to the past or future. Each of the Banks accordingly disclaims all and any responsibility or liability, whether arising in tort, contract or otherwise (save as referred to above), which it might otherwise have in respect of this Prospectus or any such statement.

Recipients of this Prospectus are authorised solely to use it for the purpose of considering the acquisition of the Ordinary Shares and may not reproduce or distribute this Prospectus, in whole or in part, and may not disclose any of the contents of this Prospectus or use any information herein for any purpose other than considering an investment in the Ordinary Shares. Such recipients of this Prospectus agree to the foregoing by accepting delivery of this Prospectus.

The Company consents to the use of this Prospectus by the Intermediaries in connection with the Intermediaries Offer in the United Kingdom, the Channel Islands and the Isle of Man (i) in respect of Intermediaries who are appointed prior to the date of this Prospectus, from the date of this Prospectus and (ii) in respect of Intermediaries who are appointed after the date of this Prospectus, from the date on which they are appointed to participate in the Intermediaries Offer, in both cases until the closing of the Intermediaries Offer. The Company accepts responsibility for the information contained in this Prospectus with respect to any subscriber for Ordinary Shares in the Offer. **Any Intermediary that uses this Prospectus must state on its website that it uses this Prospectus in accordance with the Company's consent. Intermediaries are required to provide the terms and conditions of the Intermediaries Offer to any prospective investor who has expressed an interest in participating in the Intermediaries Offer to such Intermediary. Any application made by investors to any Intermediary are subject to the terms and conditions imposed by each Intermediary.**

This Prospectus does not constitute or form part of any offer or invitation to sell or issue, or any solicitation of any offer to purchase or subscribe for, any securities other than the securities to which it relates or any offer or invitation to sell or issue, or any solicitation of any offer to purchase or subscribe for, such securities by any person in any circumstances in which such offer or solicitation is unlawful.

In making an investment decision, each investor must rely on their own examination, analysis and enquiry of the Company and the terms of the Offer, including the merits and risks involved.

The investors also acknowledge that: (i) they have not relied on the Banks or any person affiliated with the Banks in connection with any investigation of the accuracy of any information contained in this Prospectus or their investment decision; and (ii) they have relied only on the information contained in this document.

No person has been authorised to give any information or make any representations other than those contained in this Prospectus and, if given or made, such information or representations must not be relied on as having been so authorised. Neither the delivery of this Prospectus nor any subscription or sale made under it shall, under any circumstances, create any implication that there has been no change in the affairs of the Company since the date of this document or that the information in it is correct as of any subsequent time.

None of the Company, the Banks or any of their respective representatives, is making any representation to any prospective investor of the Ordinary Shares regarding the legality of an investment in the Ordinary Shares by such prospective investor under the laws applicable to such prospective investor. The contents of this Prospectus should not be construed as legal, financial or tax advice. Each prospective investor should consult his, her or its own legal, financial or tax adviser for legal, financial or tax advice.

Stabilisation

In connection with the Offer, Goldman Sachs, as Stabilising Manager, or any of its agents, may (but will be under no obligation to), to the extent permitted by applicable law, over-allot Ordinary Shares or effect other transactions with a view to supporting the market price of the Ordinary Shares at a higher level than that which might otherwise prevail in the open market. The Stabilising Manager is not required to enter into such transactions and such transactions may be effected on any securities market, over-the-counter market, stock exchange or otherwise and may be undertaken at any time during the period commencing on the date of the commencement of conditional dealings of the Ordinary Shares on the London Stock Exchange and ending no later than 30 calendar days thereafter. However, there will be no obligation on the Stabilising Manager or any of its agents to effect stabilising transactions and there is no assurance that stabilising transactions will be undertaken. Such stabilisation, if commenced, may be discontinued at any time without prior notice. In no event will measures be taken to stabilise the market price of the Ordinary Shares above the Price Range. Except as required by law or regulation, neither the Stabilising Manager nor any of its agents intends to disclose the extent of any over-allotments made and/or stabilisation transactions conducted in relation to the Offer.

In connection with the Offer, the Stabilising Manager may, for stabilisation purposes, over-allot Ordinary Shares up to a maximum of 15% of the total number of Ordinary Shares comprised in the Offer. For the purposes of allowing the Stabilising Manager to cover short positions resulting from any such over-allotments and/or from sales of Shares effected by it during the stabilising period, the Selling Shareholder has granted to it an over-allotment option (the "**Over-allotment Option**"), pursuant to which the Stabilising Manager may procure purchasers for additional Shares up to a maximum of 15% of the total number of Ordinary Shares comprised in the Offer (before any utilisation of the Over-allotment Option) (the "**Over-allotment Shares**") at the Offer Price. The Over-allotment Option is exercisable in whole or in part, upon notice by the Stabilising Manager, at any time on or before the thirtieth calendar day after the commencement of conditional dealings of the Ordinary Shares on the London Stock Exchange. Any Over-allotment Shares made available pursuant to the Over-allotment Option will rank *pari passu* in all respects with the Ordinary Shares, including for all dividends and other distributions declared, made or paid on the Ordinary Shares, will be purchased on the same terms and conditions as the Ordinary Shares being sold in the Offer and will form a single class for all purposes with the other Ordinary Shares.

Notice to overseas shareholders

United States

The Ordinary Shares have not been, nor will they be, registered under the US Securities Act of 1933, as amended (the "**Securities Act**") or under the applicable securities laws or the regulations of any state of the United States, or under the applicable securities laws of Australia, Canada or Japan, and may not be offered or sold except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and in compliance with any applicable state securities law. Subject to certain exceptions, the Ordinary Shares may not be offered or sold in the United States, Australia, Canada or Japan or to or for the account or benefit of any national, resident or citizen of Australia, Canada or

Japan. The Joint Bookrunners may offer and sell or arrange for the offer and sale of Ordinary Shares in the United States only to persons reasonably believed to be Qualified Institutional Buyers ("**QIBs**") as defined in Rule 144A under the Securities Act ("**Rule 144A**") in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A or another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and in offshore transactions outside the United States in reliance on Regulation S under the Securities Act ("**Regulation S**"). For a description of these and certain further restrictions on offers, sales and transfers of the Ordinary Shares and the distribution of this document, see Part VI: "*Details of the Offer*".

This Prospectus is being furnished by the Company in connection with an offering exempt from the registration requirements of the Securities Act, solely for the purpose of enabling a prospective investor to consider the subscription for or acquisition of Ordinary Shares described therein. The information contained in this Prospectus has been provided by the Company and other sources identified herein or therein. This Prospectus is being furnished on a confidential basis only to persons reasonably believed to be QIBs in the United States. Any reproduction or distribution of this document, in whole or in part, in the United States and any disclosure of its contents or use of any information herein in the United States for any purpose, other than in considering an investment by the recipient in the Ordinary Shares offered hereby or thereby is prohibited. Each potential investor in the Ordinary Shares, by accepting delivery of this document agrees to the foregoing.

The Ordinary Shares offered in the Offer have not been approved or disapproved by the US Securities and Exchange Commission, any state securities commission in the United States or any other US regulatory authority nor have such authorities passed upon or endorsed the merits of the offering of the Ordinary Shares or the accuracy or adequacy of this document. Any representation to the contrary is a criminal offence in the United States.

Overseas shareholders

The distribution of this Prospectus and the offer and sale of the Ordinary Shares in certain jurisdictions may be restricted by law. Other than in the United Kingdom, no action has been taken or will be taken to permit the possession or distribution of this Prospectus (or any other offering or publicity materials or application form(s) relating to the Ordinary Shares) in any jurisdiction where action for that purpose may be required or doing so is restricted by law. Accordingly, neither this Prospectus, nor any advertisement, nor any other offering material may be distributed or published in any jurisdiction except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Prospectus comes should inform themselves about and observe any such restrictions.

In addition, the Ordinary Shares are subject to restrictions on transferability and resale in certain jurisdictions and may not be transferred or resold except as permitted under applicable securities laws and regulations. Investors should be aware that they may be required to bear the financial risk of this investment for an indefinite period of time. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction. Further information with regard to the restrictions on the distribution of this Prospectus and the offering, sale and transfer and resale of the Ordinary Shares is set out at paragraph 17 (*Selling Restrictions*) in Part VI: "*Details of the Offer*". Each subscriber for Ordinary Shares will be deemed to have made the relevant representations made therein.

NOTICE TO NEW HAMPSHIRE RESIDENTS ONLY

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENCE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES ("**RSA 421-B**") WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE OF NEW HAMPSHIRE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL, TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

Dated 28 September 2012

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PART I—SUMMARY INFORMATION

*Summaries are made up of disclosure requirements known as "**Elements**". These elements are numbered in Sections A-E (A.1—E.7).*

This summary contains all the Elements required to be included in a summary for this type of securities and Issuer. Because some Elements are not required to be addressed, there may be gaps in the numbering sequence of the Elements.

Even though an Element may be required to be inserted in the summary because of the type of securities and Issuer, it is possible that no relevant information can be given regarding the Element. In this case a short description of the Element is included in the summary with the mention of "not applicable."

Section A—Introduction and warnings

Element		
A.1	**Introduction**	The following information should be read as an introduction to the more detailed information appearing elsewhere in this prospectus (the "**Prospectus**"). Any decision by a prospective investor to invest in the ordinary shares of the Company (the "**Ordinary Shares**") should be based on a consideration of the document as a whole. Investors should therefore read this entire document and not rely solely on this summary. Following the implementation of the relevant provisions of the Prospectus Directive in each member state of the European Economic Area, no civil liability will attach to the Company and the Directors in any such member state in respect of this summary, including any translation hereof, unless it is misleading, inaccurate or inconsistent when read together with the other parts of this Prospectus. Where a claim relating to the information contained in this Prospectus is brought before a court in a member state of the European Economic Area, the plaintiff may, under the national legislation of the member state where the claim is brought, be required to bear the costs of translating this Prospectus before the legal proceedings are initiated.
A.2	**Consent for intermediaries**	The Company consents to the use of this Prospectus by the Intermediaries in connection with the Intermediaries Offer in the United Kingdom, the Channel Islands and the Isle of Man (i) in respect of Intermediaries who are appointed prior to the date of this Prospectus, from the date of this Prospectus and (ii) in respect of Intermediaries who are appointed after the date of this Prospectus, from the date on which they are appointed to participate in the Intermediaries Offer, in both cases until the closing of the Intermediaries Offer. Prospective investors interested in participating in the Intermediaries Offer should apply for Ordinary Shares through the Intermediaries by following their relevant application procedures, by no later than 9 October 2012. **Intermediaries are required to provide the terms and conditions of the Intermediaries Offer to any prospective investor who has expressed an interest in participating in the Intermediaries Offer to such Intermediary. Any application made by investors to any Intermediary are subject to the terms and conditions imposed by each Intermediary.**

Section B—Issuer		
Element		
B.1	**Legal and Commercial Name**	Direct Line Insurance Group plc (the "**Company**").
B.2	**Domicile / Legal Form / Legislation / Country of Incorporation**	The Company is a public limited company, incorporated in the United Kingdom with its registered office situated in England and Wales. The Company operates under the Companies Act 2006.
B.3	**Current operations/ principal activities and markets**	The Company and its subsidiary undertakings or the "**Group**" is a retail general insurer with leading market positions in the United Kingdom and businesses in Italy and Germany. The Group has the most highly recognised brands in the United Kingdom for personal motor insurance and personal home insurance. The Group employs a multi-brand, multi-product and multi-distribution channel business model that covers most major customer segments in the United Kingdom for personal lines general insurance and a more limited presence in the commercial market. The Group's business is comprised of five reportable segments: motor, home, rescue and other personal lines, commercial and international. The Group sells its products across a range of brands, allowing it to tailor its products to different market segments. The Group's own brands include Direct Line, Churchill, Privilege, NIG and Green Flag (rescue and other personal lines) and the Group also operates through various distribution arrangements with a number of household names, including Prudential (motor, home and rescue and other personal lines), RBS/NatWest (motor, home, rescue and other personal lines and commercial), Nationwide (home and rescue and other personal lines) and Sainsbury's (motor, home and rescue and other personal lines). The Group utilises a multi-channel model to distribute its insurance products, and looks to optimise the mix of these channels for each of its products and brands. The channels used by the Group include direct to consumer sales, including over the phone and via the internet, price comparison websites ("**PCWs**") and through banks and other partners and broker channels. By tailoring the distribution channel mix for each product, the Group can target its brands across distinct customer segments, seeking to offer its customers the combination of brands, channels, product features, prices and services that best address their needs. The majority of sales of home and motor policies are achieved through direct to customer sales channels providing the Group with the opportunity to build and maintain ongoing and direct relationships with the customer. This also allows the Group to leverage its extensive range of insurance products (such as pet, travel and rescue products) with a view to enhancing cross-selling opportunities.

B.4	**Recent Trends**	At the end of 2009, the Company initiated a transformation plan to address a period of financial underperformance, which included significantly enhancing the Group's pricing capabilities, claims management system, discontinuing certain unprofitable business lines and improving operational efficiency. The Group launched its transformation plan in response to an increase in bodily injury claims (driven by increased penetration of claims management companies), an increase in no-win/no-fee arrangements and increases in periodical payment order ("**PPO**") propensity all of which contributed to a decline in the Group's profitability in 2009 and 2010. In addition, in 2009 and 2010, the Group significantly increased its technical reserves relating to motor bodily injury. Following the actions taken as part of the transformation plan in 2009 and 2010, the Group delivered significantly improved financial performance for its ongoing business in 2011 and the first half of 2012, resulting in an improvement in operating profit and a significant increase to return on tangible equity.
B.5	**Description of Issuer's group**	Until Admission, the Company will be a wholly-owned subsidiary of The Royal Bank of Scotland Group plc ("**RBS**"), a large international banking and financial services company which operates in the United Kingdom, Europe, the Middle East, the Americas and Asia and serves over 30 million customers worldwide. The Group, which constitutes the insurance division of RBS, is a retail general insurer with leading market positions in the United Kingdom and businesses in Italy and Germany. Following Admission, the Company will no longer be a wholly-owned subsidiary of RBS.
B.6	**Shareholder**	As at the date of this Prospectus, RBS or the "**Selling Shareholder**" owns 100% of the issued ordinary share capital of the Company. At Admission the Selling Shareholder will own no more than 75% of the issued share capital of the Company. There is a relationship agreement in place between RBS and the Company that will have effect from Admission. The Ordinary Shares owned by the Selling Shareholder after Admission will rank *pari passu* with other Ordinary Shares in all respects.

B.7	Selected historical key financial information

COMBINED INCOME STATEMENT

	Six months ended 30 June		Year ended 31 December		
	2012	2011	2011	2010	2009
	£ million	£ million (unaudited)	£ million	£ million	£ million
Gross earned premium	**2,034.7**	**2,367.9**	**4,522.9**	**5,152.4**	**5,330.4**
Reinsurance premium ceded	**(164.5)**	**(127.5)**	**(269.9)**	**(178.9)**	**(202.1)**
Net earned premium	**1,870.2**	**2,240.4**	**4,253.0**	**4,973.5**	**5,128.3**
Investment return	176.0	146.9	281.9	321.7	365.6
Instalment income	62.1	76.7	145.0	187.7	155.9
Other operating income	37.0	46.3	95.1	107.5	78.6
Total income	**2,145.3**	**2,510.3**	**4,775.0**	**5,590.4**	**5,728.4**
Insurance claims	(1,509.1)	(1,769.1)	(3,160.6)	(4,884.7)	(4,301.7)
Insurance claims recoverable from reinsurers	285.0	68.7	193.1	256.7	119.4
Net insurance claims	**(1,224.1)**	**(1,700.4)**	**(2,967.5)**	**(4,628.0)**	**(4,182.3)**
Commission expenses	(222.0)	(184.3)	(518.9)	(378.7)	(560.8)
Other operating expenses	(582.5)	(438.3)	(944.6)	(959.1)	(1,064.8)
Total expenses	**(804.5)**	**(622.6)**	**(1,463.5)**	**(1,337.8)**	**(1,625.6)**
Operating profit / (loss)	**116.7**	**187.3**	**344.0**	**(375.4)**	**(79.5)**
Finance costs	(10.2)	(1.4)	(2.7)	(2.7)	(4.4)
Gain recognised on disposal of subsidiary and joint venture	—	1.6	1.6	—	216.1
Profit / (loss) before tax	**106.5**	**187.5**	**342.9**	**(378.1)**	**132.2**
Tax (charge) / credit	(23.7)	(45.3)	(93.9)	106.2	0.9
Profit / (loss) for the period	**82.8**	**142.2**	**249.0**	**(271.9)**	**133.1**

RESULTS OF OPERATIONS—ONGOING OPERATIONS

	Six months ended 30 June		Year ended 31 December		
	2012	2011	2011	2010	2009
	£ million	£ million	£ million	£ million	£ million
Gross written premium—ongoing	2,058.4	2,093.2	4,124.9	4,095.3	4,171.6
Underwriting result—ongoing	**(20.0)**	**(50.2)**	**(72.3)**	**(816.2)**	**(407.2)**
Investment return—ongoing	145.4	125.5	238.7	281.4	306.3
Instalment income and other operating income—ongoing	98.8	134.2	255.5	329.1	266.5
Operating profit (loss)—ongoing	**224.2**	**209.5**	**421.9**	**(205.7)**	**165.6**

KEY PERFORMANCE INDICATORS

	Six months ended 30 June		Year ended 31 December		
	2012	2011	2011	2010	2009
	£ million	£ million (unaudited)	£ million	£ million	£ million
Ongoing operations					
Loss ratio	67.3%	74.2%	70.2%	90.2%	80.4%
Commission ratio	8.4%	7.7%	10.1%	8.9%	7.5%
Expense ratio	25.4%	20.6%	21.5%	21.4%	22.2%
Total	101.1%	102.5%	101.8%	120.5%	110.1%
Combined operating ratio-ongoing					
Motor	102.4%	107.0%	105.6%	144.1%	125.7%
Home	103.4%	98.6%	95.1%	91.0%	90.8%
Rescue and other personal lines	75.7%	82.4%	86.3%	87.0%	81.9%
Commercial	112.7%	103.7%	112.3%	121.6%	108.3%
International	103.0%	112.5%	107.6%	107.9%	109.2%
Total Combined Operating Ratio	101.1%	102.5%	101.8%	120.5%	110.1%
Ongoing in-force polices (millions)	20.1	20.0	19.4	20.0	20.1
Earnings per share—basic and diluted (pence)—Total operations	5.5p	9.5p	16.6p	(18.1)p	8.9p
Return on tangible equity	10.2%**	n/a	10.0%	(5.0)%	4.2%

** annualised

COMBINED CASH FLOW STATEMENT

	Six months ended 30 June		Year ended 31 December		
	2012	2011	2011	2010	2009
	£ million	£ million (unaudited)	£ million	£ million	£ million
Opening cash and cash equivalents	1,309.6	1,763.5	1,763.5	1,225.9	238.5
Net cash (used by) generated from operating activities before investment of insurance assets	(414.3)	(165.8)	(359.8)	89.2	(178.1)
Cash generated from investment of insurance assets	2,239.9	(673.9)	38.8	486.0	875.7
Net cash (used by) generated from investing activities	(88.0)	(33.4)	(126.2)	(31.3)	316.0
Net cash (used by) generated from financing activities	(553.4)	(0.2)	(0.5)	(0.9)	(0.8)
Effect of foreign exchange rate changes	(11.9)	14.3	(6.2)	(5.4)	(25.4)
Closing cash and cash equivalents	2,481.9	904.5	1,309.6	1,763.5	1,225.9

COMBINED BALANCE SHEET

	As at 30 June 2012	As at 31 December 2011	2010	2009
	£ million	£ million (unaudited)	£ million	£ million
Assets				
Goodwill and other intangible assets	390.9	365.8	286.1	290.3
Financial investments, cash and cash equivalents	10,081.4	10,860.1	10,671.9	10,008.2
Other assets	2,738.0	2,544.2	2,858.9	2,887.3
Total assets	**13,210.3**	**13,770.1**	**13,816.9**	**13,185.8**
Liabilities				
Insurance liabilities and unearned premium reserve	8,461.3	8,440.6	9,230.0	8,428.3
Borrowings	83.7	317.9	327.1	285.2
Other liabilities	1,501.1	1,140.3	777.7	891.7
Total liabilities	**10,046.1**	**9,898.8**	**10,334.8**	**9,605.2**
Equity				
Total invested equity	2,905.7	3,612.8	3,223.6	3,322.1
Non-controlling interest	258.5	258.5	258.5	258.5
Total equity	**3,164.2**	**3,871.3**	**3,482.1**	**3,580.6**
Total equity and liabilities	**13,210.3**	**13,770.1**	**13,816.9**	**13,185.8**

B.8 **Pro forma financial information**

The unaudited pro forma income statement and balance sheet as at 31 December 2011 have been prepared to show the effect of certain capital actions undertaken in 2012 as if these had happened on 31 December 2011. It has been prepared for illustrative purposes only in accordance with Annex II of the Prospectus Directive Regulation and should be read in conjunction with the notes set out below. Because of its nature, it addresses a hypothetical situation and therefore does not represent the Group's actual return on equity for the six months ended 30 June 2012, nor its financial position as at 31 December 2011.

Income statement for the six months ended 30 June 2012

	Six months ended 30 Jun 12	Interest on Subordinated liabilities	Unaudited pro forma
	£ million Note 1	£ million Note 2	£ million
Gross earned premium	2,034.7	—	2,034.7
Reinsurance premium ceded	(164.5)	—	(164.5)
Net earned premium	**1,870.2**	**—**	**1,870.2**
Investment return	176.0	—	176.0
Instalment income and other operating income	99.1	—	99.1
Total income	**2,145.3**	**—**	**2,145.3**
Insurance claims	(1,509.1)	—	(1,509.1)
Insurance claims recoverable from reinsurers	285.0	—	285.0
Net insurance claims	**(1,224.1)**	**—**	**(1,224.1)**
Commission expenses	(222.0)	—	(222.0)
Other operating expenses	(582.5)	—	(582.5)
	(804.5)	**—**	**(804.5)**
Operating profit	**116.7**	**—**	**116.7**
Finance Costs	(10.2)	(15.8)	(26.0)
Profit before tax	**106.5**	**(15.8)**	**90.7**
Tax (charge) credit	(23.7)	3.9	(19.8)
Profit for the period	82.8	(11.9)	70.9

Balance Sheet as at 31 December 2011 and 30 June 2012

	As at 31 Dec 2011	Adjustments: Issue of Subordinated liabilities	Adjustments: Dividends paid	Unaudited pro forma	As at 30 Jun 2012
	£ million	£ million	£ million	£ million	£ million
	Note 1	Note 2	Note 3		Note 1
ASSETS					
Goodwill and other intangible assets	365.8	—	—	365.8	390.9
Financial investments	9,480.3	—	—	9,480.3	7,515.8
Cash and cash equivalents	1,379.8	500.0	(800.0)	1,079.8	2,565.6
Other assets	2,544.2	—	—	2,544.2	2,738.0
Total assets	**13,770.1**	**500.0**	**(800.0)**	**13,470.1**	**13,210.3**
EQUITY					
Total invested equity	**3,612.8**	**—**	**(800.0)**	**2,812.8**	**2,905.7**
Non-controlling interest	258.5	—	—	258.5	258.5
Total equity	**3,871.3**	**—**	**(800.0)**	**3,071.3**	**3,164.2**
LIABILITIES					
Total liabilities	**9,898.8**	**500.0**	**—**	**10,398.8**	**10,046.1**
Total equity and liabilities	**13,770.1**	**500.0**	**(800.0)**	**13,470.1**	**13,210.3**

Notes

1. The income statement for the six months ended 30 June 2012 and the balance sheets as at 31 December 2011 and as at 30 June 2012 are all extracted, without material adjustment, from the historical financial information set out in Part XIII.

2. The Group issued £500 million of subordinated notes, on 27 April 2012, at a fixed rate of interest of 9.25%. The adjustments, which have a continuing effect, show the issue of the Notes and at the associated additional interest charge, net of taxation. The additional interest charge is calculated at a rate of 9.25% on the £500 million subordinated loan notes for the six months ended 30 June 2012, which amounts to £23.2 million, less the actual interest charge on the subordinated loans for the six months ended 30 June 2012, of £7.4 million giving a net increase in finance costs of £15.8 million. The taxation credit applicable to the additional interest charge, of £15.8 million, is calculated by applying at the Group's standard rate of tax for the six months ended 30 June 2012, of 24.5%, resulting in a tax credit of £3.9 million. The net overall impact of these adjustments is to reduce profit after tax by £11.9 million.

3. The Group paid a dividend of £300 million on 27 March 2012 and a dividend of £500 million on 6 June 2012.

4. Pro forma return from ongoing operations on tangible invested equity for the six months ended 30 June 2012 is calculated as the adjusted profit, of £149.7 million divided by the average pro forma tangible invested equity of £2,480.9 million, and is quoted on an annualised basis. The calculations of adjusted profit and average pro forma tangible invested equity are shown below.

Adjusted profit is calculated as follows:

	Six months ended 30 June 2012
	£ million
Profit before tax, as reported	106.5
Adjusted for:	
Operating profit for run-off activities	(1.2)
Restructuring and other one-off costs	108.7
Profit before tax from ongoing operations	214.0
Tax on profit from ongoing operations	(52.4)
Adjustment for interest on subordinated liabilities (net of tax) See Note 2	(11.9)
Adjusted profit from ongoing operations	**149.7**

Operating profit of run-off activities, and restructuring and other one-off costs, for the six months ended 30 June 2012 are both extracted, without material adjustment, from Note 4 of the historical financial information set out in Part XIII: "*Financial Information*". Tax on profit from ongoing operations of £52.4 million, is calculated by applying the Group's standard rate of tax for the six months ended 30 June 2012 of 24.5% to the profit before tax from ongoing operations, of £214.0 million.

Average pro forma tangible invested equity represents the mean of tangible invested equity as at 31 December 2011 and as at 30 June 2012, as follows:

	As at 31 December 2011	As at 30 June 2012
	£ million	£ million
Total invested equity	2,812.8	2,905.7
Less:		
Goodwill and other intangible assets	(365.8)	(390.9)
Tangible invested equity	2,447.0	2,514.8
Average pro forma tangible invested equity		**2,480.9**
Pro forma return from ongoing operations on tangible invested equity for the six months ended 30 June 2012		6.0%
Annualised pro forma return from ongoing operations on tangible invested equity for the six months ended 30 June 2012		**12.1%**

The annualised pro forma return from ongoing operations on tangible invested equity for the six months ended 30 June 2012 has been calculated by doubling the pro forma return from ongoing operations on tangible invested equity for the six months ended 30 June 2012. No account therefore has been taken of any seasonality in the Group's business.

B.9	**Profit forecast/estimate**	Not applicable; there is no profit forecast or estimate.
B.10	**Audit Report—qualifications**	Not applicable; there is no audit report. There are no qualifications in the accountant's report on the historical financial information.
B.11	**Working Capital**	Not applicable; the Company has sufficient working capital for its present requirements.

Section C—Securities

Element		
C.1	**Description of the Offer**	The Offer comprises up to 500,000,000 ordinary shares in the Company, which are currently in issue as of the date of this Prospectus and are to be sold by the Selling Shareholder (the "**Offer Shares**"). The Offer Shares to be sold under the Offer will represent up to 33.3% of the issued share capital of the Company immediately following Admission of the Ordinary Shares to trading on the London Stock Exchange's main market for listed securities and their admission to the Financial Services Authority's Official List.

		No new Ordinary Shares will be issued by the Company under the Offer. The Offer comprises an Institutional Offer and an Intermediaries Offer. Under the Institutional Offer, the Offer Shares are being sold to certain institutional and professional investors in the United Kingdom and elsewhere outside the United States in reliance on Regulation S under the Securities Act and to QIBs in the United States in reliance on Rule 144A under the Securities Act or another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Under the Intermediaries Offer, the Offer Shares are being offered to intermediaries in the United Kingdom who will facilitate the participation of their retail investor clients in the United Kingdom, the Channel Islands and the Isle of Man. There is no specific number of Offer Shares reserved for allocation under the Intermediaries Offer. In addition, Over-allotment Shares (representing approximately 15% of the maximum number of Offer Shares) are being made available by the Selling Shareholder pursuant to the Over-allotment Option. When admitted to trading, the Ordinary Shares will be registered within ISIN number GB00B89W0M42 and SEDOL number B89W0M4.
C.2	**Currency of Issue**	British pounds sterling.
C.3	**Issued Share Capital**	The nominal value of the issued ordinary share capital of the Company is £150.0 million divided into 1,500 million ordinary shares of 10.0p each, which are issued fully paid.
C.4	**Rights attaching to the Ordinary Shares**	• The Ordinary Shares rank equally for voting purposes. On a show of hands each Shareholder has one vote and on a poll each Shareholder has one vote per Ordinary Share held. • Each Ordinary Share ranks equally for any dividend declared. Each Ordinary Share ranks equally for any distributions made on a winding up. • Each Ordinary Share ranks equally in the right to receive a relative proportion of shares in case of a capitalisation of reserves.
C.5	**Restrictions on transfer**	The Ordinary Shares are freely transferable and there are no restrictions on transfer.
C.6	**Admission to Trading**	Application has been made for all the Ordinary Shares in the Company to be admitted to trading on the London Stock Exchange's main market for listed securities.

C.7	**Dividend policy**	The Board has adopted a progressive dividend policy for the Company which will look to increase the dividend annually in real terms to reflect the cash-flow generation and long-term earnings potential of the Company. It is expected that one-third of the annual dividend will be paid in the fourth quarter as an interim dividend and two-thirds will be paid as a final dividend in the second quarter of the following year. On 3 September 2012, the Company paid a dividend of £200 million to the Selling Shareholder. If the Company makes a post-tax profit in respect of the relevant period, it intends to pay a final dividend for the financial year ending 31 December 2012 in the second quarter of 2013. If payable, any dividend would be based on a payout ratio between 50% and 60% of any consolidated post-tax profit from the Company's ongoing business before restructuring costs for the financial year ending 31 December 2012. If paid, the Board currently expects this dividend will be used as a base for future dividend payments.
Section D—Risks		
Element		
D.1	**Risks that are specific to the Issuer or its industry**	***Insurance and expense risk*** • Due to the uncertain nature and timing of the risks which the Group incurs in underwriting insurance products, including those which are unknown, the Group cannot precisely determine the amounts that it will ultimately pay to meet the liabilities covered by the insurance policies underwritten or when those liabilities will be paid. As a result, the Group's technical reserves may prove inadequate to cover actual claims costs and related expenses. • The Group's underwriting assumptions and risk pricing models may not reflect its actual overall risk exposure. The Group's actual claims and expense experience or investment income may differ from the underlying assumptions and estimates it used in establishing such liabilities or pricing its business. The Group's pricing may be inconsistent with the market price for similar insurance products. • The Group may not achieve its financial or operational targets, including return on tangible equity, combined operating ratios and gross annual cost and claims handling savings, or realise all or part of the benefits that it expects from its current transformation plan. As a result there is a significant risk that the targeted improvements to its longer-term financial performance will not be realised. ***Current economic and wider market conditions*** • A further, material, economic downturn or a breakup of the eurozone could have a significant impact on the Group's business, from an investment income and an operational perspective. • The Group is particularly exposed to the economic, market, fiscal, regulatory, legislative, political, social and weather conditions in the United Kingdom and wider European region including natural or man-made catastrophic events. Adverse changes in relation to any of these examples could lead to volatility in the Group's results of operations due to the concentration of its home and motor business in the UK.

- The Group's investment returns are highly susceptible to changes in the financial markets that could have a significant adverse effect on the value of the Group's investment portfolio.
- A decrease in the Ogden discount rate or an increase in the propensity of PPO awards for bodily injury claims, a default/non-payment on its reinsurance or increased longevity could increase the likelihood of a mismatch between the assumptions underlying the historical and future pricing of the Group's products and its claims assumptions, when compared with the actual claims and expense experience.

Reinsurance availability and counterparty risk

- Reinsurance may not be available and reinsurers may default on their reinsurance obligations which may result in the Group holding insufficient reinsurance to cover its losses.

Changes in laws, regulations and government policies

- The Group is subject to extensive regulatory supervision, both in the UK and internationally. Failure to comply with regulations, applicable insurance laws and public approvals and policies may lead to fines, revocation of its licences, disciplinary action and reputational damage with the consequent impact on its financial position. Government regulators have been giving increasing attention to consumer concerns. In addition, new UK regulatory bodies are in the process of being established which will impact how the Group will interact with its financial services regulators going forward.
- The impact to the Group of changes in legislation and regulation is uncertain. Changes include the implementation of gender-neutral pricing at the end of 2012, the Legal Aid, Sentencing and Punishment of Offenders Act 2012, the reforms proposed by Lord Justice Jackson (and related to that act and those reforms, the pending decision in *Simmons v. Castle*), the proposed ban of legal referral fees, potential amendments to the Ogden discount rate (and its subsequent impact on the value of PPO awards) and, more broadly, the introduction of wider powers to regulate insurance products, including their fairness and appropriateness for the end consumer, with the potential imposition of remediation activity.
- The Group is subject to extensive financial, including capital, regulatory requirements. There is significant uncertainty surrounding the requirements of Solvency II, including the date of its implementation, and there can be no assurance that the Group will not need to strengthen its solvency capital position or modify its business operations and processes if and when Solvency II takes effect, even if the Group receives FSA approval of its internal model.

Competition

- The Group faces significant competition that continues to intensify through the development of alternative distribution channels such as PCWs, changes in consumer behaviour and technological advances. This could result in greater pricing pressure as well as a reduction in the Group's insurance market share.

Brands and distribution arrangements

- The Group's success and results are dependent on the strength and reputation of its own brands and its distribution partner brands. Litigation, employee misconduct, operational failures, the outcome of regulatory or other investigations, press speculation, negative publicity and changes in customers' expectations for the Group's products amongst others, could damage its brands or reputation.
- The Group's distribution arrangements with its partners are material to the Group's current financial performance. Cessation of these arrangements could have a material adverse effect on such performance.

Reliance on operational processes and technology and communication systems

- The Group relies heavily on its operational processes and technology and communication systems ("**IT**"). These processes and systems may not operate as expected or may not fulfil their intended purpose.
- As part of its separation from the RBS Group, the Group has begun to implement new IT systems and processes in order to operate on a stand-alone basis including through new arrangements with third party suppliers. These new systems may be inferior to those previously provided by the RBS Group or may be on less favourable terms.
- Whilst the Group has in place disaster recovery systems processes and security measures, aimed at protecting against IT and related systems or operational failure or disruption, the occurrence of a serious disaster resulting in interruptions, delays, the loss or corruption of data or the cessation of the availability of systems or infrastructure could have a material adverse impact on the Group's overall operational or financial performance.
- The Group is dependent on the use of third party IT, software, data and service providers. The Group also relies on a transitional services agreement ("**TSA**") with the RBS Group, particularly with respect to the provision of IT services by the RBS Group. The TSA provides for the RBS Group to assist with the migration of Group-owned systems operated by the RBS Group and data from the RBS Group infrastructure to that of the Group or third parties at or prior to the end of the TSA period. As with all of the Group's IT systems, interruptions to or problems with the Group's IT systems and services provided by third parties under the TSA or as a result of migration from the RBS Group infrastructure could cause material damage to the Group's business and reputation.

Ownership by the RBS Group

- If, after Admission the RBS Group fails to complete the disposal of its interests in the Group or fails to do so within the time limits prescribed by the European Commission, a divestiture trustee may be empowered to conduct the disposal of the RBS Group's residual interest in the Ordinary Shares of the Group at no minimum price.

		• The disposal of the RBS Group's interests in the Group held after Admission could be achieved in a single tranche or by the sale of a significant tranche representing in excess of 30% of the issued share capital of the Company. Any such sales could, absent the consent of the UK Takeover Panel, require a purchaser to make an offer to acquire all the Ordinary Shares not held by it at the price at which the Residual Shares are sold, and there can be no guarantee that the price at which the RBS Group is willing to sell its Residual Shares will be at a level that the Board is prepared to recommend to Shareholders. Depending on the level of ownership secured by a purchaser in an offer, Ordinary Shares could be subject to compulsory acquisition under the UK Companies Act and the delisting of the Ordinary Shares from the Official List.
D.3	**Risks relating to the Ordinary Shares**	• The Selling Shareholder is required to cede control of the Company beyond 2013 and divest of any remaining interest by the end of 2014. As a result, subject to the lock-up provisions that prevent the Selling Shareholder from disposing of any Ordinary Shares until the period of 180 days from Admission without the consent of the Joint Global Coordinators, there will be substantial sales of the Ordinary Shares the Selling Shareholder holds in the Company in 2013 and 2014, which could have a negative affect on the market price of the Ordinary Shares. The Company has no control over the timing or nature of such sales, and how much of the Selling Shareholder's interest may be sold at any one time.
	Section E—Offer	
Element		
E.1	**Net Proceeds/Expenses**	The net proceeds (after deducting underwriting commissions, other estimated offering-related fees and expenses, VAT and stamp duty of approximately £21.2 million) from the Offer for the Selling Shareholder will be approximately £755.3 million assuming that the number of Offer Shares sold is the mid-point between 25.0% and 33.3% of the total number of issued Ordinary Shares and the Offer Price is set at the mid point of the Price Range. No expenses will be charged by the Issuer or the Selling Shareholder to the purchasers of Offer Shares.
E.2	**Reasons for the Offer/ Use of Proceeds**	In 2009, as a condition to its receipt of State Aid, the Selling Shareholder committed to the European Commission to undertake a series of measures, which include disposing of its interest in the Group. To comply with this requirement, the RBS Group must cede control of the Group by the end of 2013 and must have divested its entire interest by the end of 2014. The reason for the Offer is that the Selling Shareholder determined that its preferred strategy to satisfy its commitment to the European Commission was a divestment by way of an IPO of the Company (together with subsequent sales of its residual post-Admission interest in the Company). No proceeds will be received by the Company pursuant to the Offer.
E.3	**Terms and Conditions of the Offer**	Under the Offer, all Offer Shares will be sold at the Offer Price which will be determined by the Selling Shareholder in consultation with the Joint Bookrunners and the Company. It is currently expected that the Offer Price will be within the Price Range, although it may be set above or below this range. A number of factors will be considered in deciding the Offer Price and the bases of allotment under the Offer, including the level and nature of demand for Ordinary Shares and the objective of encouraging the development of an orderly after-market in the Ordinary Shares.

		The Offer comprises an Institutional Offer and an Intermediaries Offer. Under the Institutional Offer, the Offer Shares are being sold to certain institutional and professional investors in the United Kingdom and elsewhere outside the United States in reliance on Regulation S under the Securities Act and to QIBs in the United States in reliance on Rule 144A under the Securities Act or another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Under the Intermediaries Offer, the Offer Shares are being offered to intermediaries in the United Kingdom who will facilitate the participation of their retail investor clients in the United Kingdom, the Channel Islands and the Isle of Man. In addition, Over-allotment Shares (representing approximately 15% of the maximum number of Offer Shares) will be made available by the Selling Shareholder pursuant to the Over-allotment Option. Admission is expected to become effective, and unconditional dealings in the Ordinary Shares are expected to commence on the London Stock Exchange, at 8.00 a.m. on 16 October 2012. It is expected that dealings in the Ordinary Shares will commence on a conditional basis on the London Stock Exchange at 8.00 a.m. on 11 October 2012. The earliest date for settlement of such dealings will be 16 October 2012. All dealings in Ordinary Shares prior to the commencement of unconditional dealings will be on a "when issued basis", will be of no effect if Admission does not take place, and will be at the sole risk of the parties concerned. The Offer is subject to the satisfaction of conditions which are customary for transactions of this type contained in the Underwriting Agreement, including Admission becoming effective by no later than 8.00 a.m. on 16 October 2012, determination of the Offer Price, and on the Underwriting Agreement not having been terminated prior to Admission. None of the Ordinary Shares may be offered for subscription, sale or purchase or be delivered, or be subscribed, sold or delivered, and this Prospectus and any other offering material in relation to the Ordinary Shares may not be circulated, in any jurisdiction where to do so would breach any securities laws or regulations of any such jurisdiction or give rise to an obligation to obtain any consent, approval or permission, or to make any application, filing or registration.
E.4	**Material Interests**	Other than disclosed in B.6, there are no other interests including conflicting interests that are material to the Offer.
E.5	**Selling Shareholder/ Lock-up Arrangements**	The Offer Shares under the Offer are being sold by the Selling Shareholder. The Selling Shareholder is subject to a 180-day lock-up period following Admission, during which time it may not dispose of any interest in its Ordinary Shares without the consent of the Joint Global Coordinators. For a 180-day lock-up period, the Company will not issue or dispose of any new Ordinary Shares. The Directors are subject to a 360-day lock-up period during which they will not sell any Ordinary Shares they own in the Company. All lock-up arrangements are subject to certain customary exceptions.

E.6	**Dilution**	Not applicable; no new Ordinary Shares are to be issued under the Offer.
E.7	**Estimated expenses charged to investor**	Not applicable; there are no commissions, fees or expenses to be charged to investors by the Company or the Selling Shareholder under the Institutional Offer. All expenses incurred by any Intermediary are for its own account. Investors should confirm separately with any Intermediary whether there are any commissions, fees or expenses that will be applied by such Intermediary in connection with any application made through that Intermediary pursuant to the Intermediary Offer. The Intermediaries, as at the date of this Prospectus, have informed the Company that the aggregate commissions, fees and expenses to be charged by them in relation to the Intermediaries Offer to any of their respective clients acquiring Ordinary Shares in the Intermediaries Offer will range from 0% to 2% of the amount paid by such clients for the Ordinary Shares. To the extent that there is any change in the amount of such commissions, fees and expenses to be charged to clients of Intermediaries that arises after the date of this Prospectus, including as a result of the appointment of additional Intermediaries, this information will be made available on the Company's website at www.directlinegroup.com.

Any investment in the Ordinary Shares is subject to a number of risks. Prior to investing in the Ordinary Shares, prospective investors should consider carefully the factors and risks associated with any investment in the Ordinary Shares, the Group's business and the industry in which it operates, together with all other information contained in this Prospectus including, in particular, the risk factors described below.

The following is not an exhaustive list or explanation of all risks which investors may face when making an investment in the Ordinary Shares and should be used as guidance only. Additional risks and uncertainties relating to the Group that are not currently known to the Group, or that it currently deems immaterial, may individually or cumulatively also have a material adverse effect on the Group's business, prospects, results of operations and financial position and, if any such risk should occur, the price of the Ordinary Shares may decline and investors could lose all or part of their investment. Investors should consider carefully whether an investment in the Ordinary Shares is suitable for them in the light of the information in this Prospectus and their personal circumstances.

RISKS RELATING TO THE GROUP

The Group's technical reserves may not adequately cover actual claims

Due to the uncertain nature and timing of the risks which the Group incurs in underwriting insurance products, it cannot precisely determine the amounts that it will ultimately pay to meet the liabilities covered by the insurance policies underwritten or the timing of payment and settlement of those liabilities. As such, the Group's technical reserves may prove to be inadequate to cover actual claims costs, particularly when the settlement of liability or payments of claims may not occur until well into the future, for example, and in particular, for bodily injury claims.

The Group maintains technical reserves to cover the estimated cost of future claims payments and related administrative expenses, with respect to losses or injuries which have been incurred but have not been fully settled at the balance sheet date or which may occur in the future against insurance policies which have already been written prior to the balance sheet date. This includes losses or injuries that have been reported to the Group and those that have not yet been reported. The technical claims reserves maintained by the Group represent estimates of all expected future payments, including related administrative expenses, to bring every claim (whether reported or not) which has occurred prior to the balance sheet date to final settlement. The Group's premium reserves represent the higher of unexpired premiums or the estimated ultimate cost of the Group's exposure to claims and expenses occurring after the balance sheet date against business which was written prior to such date.

The Group estimates technical reserves using a range of actuarial and statistical projections and assumptions across a range of variables such as the time required to learn of and settle claims, facts and circumstances known at a given time, estimates of trends, trends in the number of claims or claims of certain types, inflation in claims severity and expected future claims payment patterns. Estimates are also dependent on other variable factors including the legal, social, economic and regulatory environments, results of litigation, rehabilitation and mortality trends, business mix, consumer behaviour, market trends, underwriting assumptions, risk pricing models, inflation in medical care costs, future earnings inflation and other relevant forms of inflation, exchange rate movements, the cost of repairs and replacement, and estimated future receipts from third parties such as other insurers and reinsurance recoveries, as well as changes in internal claims handling processes. The inevitable variations in any of these factors contribute to the uncertainty of the technical reserves estimate. While most of the Group's technical reserves are held on an undiscounted basis and, therefore, do not allow for the investment income which will be earned on the technical reserves after the balance sheet date up until the claims are fully settled, the technical reserves held in respect of periodical payment orders ("**PPOs**") are held on a discounted basis. The size and nature of the PPO reserves are also exposed to the risk of changes in mortality, cost of care, advances in medical treatment and associated costs and other inflation, the timing of future cash flows or level of investment income. The Group's employers' liability business is also exposed to the risk of disease related claims in respect of currently unknown exposures being identified at a future date.

For claims, especially those which take several years to settle, such as bodily injury, illness, and public and employers' liability, it has been necessary historically, and may over time continue to be necessary, for the Group to revise its estimates of the total costs to settle the claims and, therefore, increase or release its related technical reserves.

The Group's technical reserves are particularly susceptible to potential retrospective changes in legislation and new court decisions. For example, a change in the "Ogden discount rate", which is the discount rate set by the UK government and used (among other things) by courts to calculate lump sum awards in bodily injury cases, would impact all relevant claims settled after that date, regardless of whether the insurance to which the claim relates was priced on that basis or not. Changes to the Ogden discount rate can result from changes in or volatility of interest rates and/or changes in the cost of care and other medical cost inflation, and there is a particular risk that sustained low interest rates may lead to increased pressure to reduce the Ogden discount rate. In particular, a review has recently been initiated by the Ministry of Justice, the Scottish Government and the Department of Justice, Northern Ireland, which together released a paper on 1 August 2012 soliciting views on changes to the methodology for setting the Ogden discount rate. A reduction in the Ogden discount rate would have the effect of increasing the present value of lump sum awards, thereby increasing the amount the Group would need to pay to settle certain claims. Increases or decreases to the Ogden discount rate can also affect the propensity of PPO claims.

The award of PPOs to settle bodily injury claims, in which annually indexed payments are made periodically over several years or even the lifetime of the injured party, could also increase. Any changes in the propensity for claimants to settle bodily injury claims using a PPO relative to the estimates made when setting the technical reserves would have a similarly retrospective effect. The recent increase in the utilisation of PPOs to settle bodily injury claims makes the estimation of technical reserves increasingly complex and uncertain due to the increased range of assumptions required, such as the future propensity of such settlement methods, estimated rates of inflation, estimated mortality trends for impaired lives, payment patterns, investment income and the impact of reinsurance recoveries which will occur many years into the future with a resultant increase in the associated credit or other non-payment risk. The fact that these claims take many years to ultimately settle increases the uncertainty around their estimation, which could have a material adverse effect on the Group's business, prospects, results of operations and financial position, particularly because of the increasing proportion of claims reserves that the board of directors of the Company (the "**Board**") believes these claims will represent in the future.

Consequently, changes in any of these trends or other variable factors, including risks around the accuracy of the data used to estimate the technical reserves, may result in actual future claims costs and related expenses paid differing, potentially significantly, from the estimates reflected in the claims and premium reserves in the Group's financial statements. To the extent that the Group's technical reserves are subsequently estimated to be insufficient to cover the future cost of claims or administrative expenses, it will have to increase its technical reserves and incur a corresponding reduction in its earnings/net income in the period in which the deficiency is identified. In addition, if the Group's technical reserves are excessive as a result of an over-estimation of risk, it may set premiums at levels which are too high and potentially may not be able to compete effectively, which may result in a loss of customers and premium income. Over-estimation of reserves can also lead to reserve releases in future periods, the effect of which is higher profit from operations than the Group would otherwise have achieved in those periods. In recent periods, the Company has earned substantial profits from releases of reserves from prior years, and there can be no assurance that the Group will be able to make similar releases in future periods. Conversely, if the Group charges premiums that are insufficient for the cover provided, it may suffer underwriting losses, leading to a reduction in earnings. Both of these could have a material adverse effect on its current and future business, prospects, results of operations and financial position. Any increase in the technical reserves held and/or estimates or expectations of the uncertainty around those technical reserves could also lead to increased capital being required and increased uncertainty around the Group's current and future profitability.

The Group's underwriting assumptions and risk pricing models may not reflect its overall risk exposure

The Group's results depend significantly on whether its actual claims and expense experience, and investment income experience, in terms of ultimate cost and timing of cash flows, is consistent with the assumptions and pricing models it has used in underwriting and setting prices for its products. These assumptions are based on a variety of factors which may include historical data, estimates, assumptions or individual expert judgements in respect of known or potential future changes and statistical projections of what the Group believes will be the costs and cash flows of its assets and liabilities. If the Group's actual claims and expense experience, or investment income, differ from the underlying assumptions and estimates it used in establishing such assets and liabilities or pricing its business, or if the Group's pricing is different to the market price for similar insurance products, this would have an adverse effect on the Group's revenue generation, profit and financial position. In 2009 and 2010, the Group experienced a significant increase in bodily injury claims resulting in part from the rise of claims management companies,

an increase in no-win/no-fee litigation, an increase in fraud and an increase in PPOs, all of which contributed to significant financial underperformance, as the Group's underwriting and pricing assumptions had not taken into account these developments at the time the risk was priced.

Statistical methods, models or individual expert judgements may not accurately quantify the Group's risk exposure, including if circumstances arise that were not observed in the historical data or if the data otherwise proves to be inaccurate or inappropriate. In addition, the statistical methods, models or individual judgements themselves may be flawed, leading to inaccurate pricing of risk despite access to accurate data and accurate assessment of other risks. The Group's ability to quantify risk exposure, and as a result price insurance products successfully, is subject to risks and uncertainties including, without limitation: exposure to claims inflation; changes in claims frequency; unanticipated legal and regulatory changes and costs; changes in mortality or rehabilitation trends; assumptions on weather trends; unexpected or new types of claims; changes in social or market trends, including customer and claimant behaviour; changes in economic conditions; potential inaccuracies in the data collected from internal or external parties and/or used within the modelling and pricing processes; incorrect or incomplete analysis of data; potentially inaccurate or inappropriate policy terms and conditions; inappropriate or incomplete purchase of reinsurance or receipt of recoveries therefrom; changes in the internal operating environment within the Group; the selection of inappropriate pricing methodologies; assumptions for future investment income and the uncertainties inherent in estimates and assumptions, including those used throughout the pricing and underwriting processes.

The actual claims payments may vary, perhaps significantly, from those estimated both in amount and in timing of payments, particularly if the payments occur well into the future. This may have a material adverse effect on the Group's business, prospects, results of operations and financial position and it may be necessary for the Group to increase prices for future insurance policies and to set aside additional reserves for existing, previously written policies, as well as increasing the capital it will be required to hold due to the increased uncertainty around future profitability.

The Group may fail to execute its ongoing strategic transformation plan and/or the expected benefits of that plan may not be achieved at the time or to the extent expected, or at all

Following a period of underperformance, which led the Group to increase its technical reserves in 2009 and 2010, in the second half of 2009 the Group began implementing a range of measures aimed at improving its longer term financial performance, including increasing prices for insurance products in some business lines, assessing and pricing underwriting risk more accurately, exiting unprofitable business lines (such as fleet, taxi, motorcycle and personal lines business sold via brokers), and enhancing its reserving processes and reducing costs. The Group has also implemented steps designed to upgrade and enhance many of its operational processes and systems, including enhancing its enterprise-wide risk management framework that is intended to integrate its risk, business and capital strategies (see Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Risk Management—Enterprise-wide risk management framework*").

Beginning in 2012, the Group commenced further initiatives with the aim of achieving enhanced distribution of its products, pricing accuracy, improved claims handling and additional cost savings in future periods, as well as strengthening risk and capital management. These new measures, systems and processes remain in development and their performance and effectiveness are not yet proven, and therefore they may not deliver the expected benefits to the Group and could lead to unintended significant disruptions to the Group's operations. The Group may not be able to achieve the targeted cost savings by 2014 or at all (see Part VII: "*Information on the Company and the Group—Strategy—Operational efficiency—realise the significant cost opportunity*"). Furthermore, the successful implementation of additional initiatives is contingent upon a range of factors, both internally driven, such as the ability of the organisation to effectively and appropriately implement IT or business change, and those which are beyond the Group's control, including market conditions, the general business environment, regulation (including unexpected regulatory change), the activities of its competitors and consumers and the legal and political environment.

There can be no assurance that the Group will be able to achieve its financial or operational targets (including its targets for return on tangible equity, combined operating ratio and gross annual cost and claims handling savings) or realise all or part of the benefits that it expects from its current plans or other future initiatives. In particular, the amount of the gross annual cost and claims handling savings from the Group's cost and operational efficiency initiatives may be different to the target of £100 million, and/or the savings may not be realised by the end of 2014 or at all. The Group may be unable to implement one or

more of its initiatives successfully, in whole or in part when expected or targeted, or at all and may experience unexpected cost increases that more than offset any savings that it may achieve or may suffer from changes in the external environment that erode any potential benefits. Moreover, the Group may face extended delays and other execution problems in implementing its strategic transformation plan. Given the continued competitive pricing pressures experienced in the Group's industry, the Group's failure to realise cost savings and other such benefits when expected or targeted would adversely affect the Group's business, prospects, results of operations and financial position.

The Group's results depend on the performance of its investment portfolio, and changes in the financial markets may have a significant adverse effect on the value of the Group's investment portfolio

The Group's investment returns, which are a significant contributor to the Group's profitability in any given year, are highly susceptible to changes in interest rates and credit spreads. The Group's investment returns are subject to a variety of risks, including risks related to general global economic conditions (including those in the eurozone), market volatility and interest rate fluctuations, liquidity risk, and credit risk. Changes in these factors can be very difficult to predict. For more information on the Group's investment portfolio, see Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Investments*".

The value of the Group's fixed income portfolio will be affected by markets in interest rates, changes in the credit ratings of the issuers of the securities, and liquidity generally in the bond markets, which may affect returns on, and the market values of, UK and international fixed-income investments in the Group's investment portfolios. Generally, investment income may be reduced during sustained periods of lower interest rates as higher yielding fixed-income securities are called, mature or are sold and the proceeds reinvested at lower rates, even though prices of fixed-income securities tend to be higher and gains realised upon their sale tend to increase under such circumstances. During periods of rising interest rates, prices of fixed income securities tend to fall and realised gains upon their sale are reduced or realised losses are increased, but reinvestments take place at a higher yield. When the credit rating of the issuer of the debt securities falls, or the credit spread with respect to the issuer increases, the value of the fixed income securities may also decline. A substantial part of the Group's fixed income securities are classified as "available for sale" in its accounts, such that changes in asset values attributable to interest rate and credit changes are reflected in other comprehensive income on the Group's balance sheet. Changes to the amortised cost resulting from changes in currency exchange rates in which the Group's fixed income securities are held are reflected in the Group's income statement, whereas currency changes that impact the fair value of the Group's investment assets and other comprehensive income are reflected in the Group's balance sheet.

The Group is directly and indirectly exposed to the credit of sovereign states, financial services institutions and other sectors such as utilities. In particular, the Group's fixed income portfolio contains a number of debt instruments issued by UK and European financial services institutions, two of the largest holdings of which, as at 30 June 2012, were issued by the European Investment Bank and the RBS Group, as well as sovereign states, including the United Kingdom. See "*—The Group's business is concentrated in the United Kingdom*". The value of those instruments has been and may continue to be adversely affected by developments in the global sovereign debt markets, the global economy as a whole and developments specific to the issuers of those securities. While the Group currently only has material sovereign related exposure to securities issued by the United Kingdom, it also holds securities issued by certain other European governments, most notably France. In addition, there can be no assurance that it will not have more varied exposure in the future, that it will not incur losses as a result of indirect exposure, or that the risks associated with its direct holdings will not increase as a result of adverse changes in the sovereign debt markets.

The Group's investment portfolio also contains interest-rate-sensitive instruments that may be adversely affected by changes in interest rates, particularly its cash holdings (a significant proportion of which are currently held with the RBS Group). Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions, and other factors beyond the Group's control. The Group may not be able to appropriately or effectively mitigate interest rate sensitivity in a changing interest rate environment. In particular, a significant increase in interest rates could result in significant losses, realised or unrealised, in the fair value of the Group's current investment portfolio and, consequently, could have an adverse effect on its results of operations and capital position. Lower interest rates could also affect income derived from fixed income investments as borrowers seek to refinance at lower interest rates, redeeming current debt instruments and requiring the Group to reinvest the proceeds in securities with lower interest yields. A changing interest rate environment will also impact the Group's returns on its substantial cash holdings.

Because of the unpredictable nature of the frequency, size and timing of losses, including payments, that may arise under the Group's insurance policies, the Group's liquidity needs could be substantial from time to time. Illiquidity of certain investments may prevent the Group from selling assets in a timely manner. This may force the Group to liquidate its investments at times and prices that are not optimal. This could have a material adverse effect on the performance of its investment portfolio and therefore a material adverse effect on the Group's business, prospects, results of operations and financial position.

The Group is also considering future changes to the nature and type of investment portfolio it holds with the aim of increased diversification, through changes in the mix of asset types held, duration and currency of denomination, which could result in future investment returns, including future investment gains, being lower and/or more volatile. As part of this strategy the Group began investing a portion of its assets in instruments denominated in US dollars in the first half of 2012. The Group intends to hedge most of its foreign exchange risks in the future and has executed hedges with respect to its US dollar investments. If those hedges prove ineffective or are not entered into, the impact of fluctuation in foreign currency exchange rates could adversely affect its business, prospects, results of operations and financial position.

The Group also intends to increase its investments in UK real estate, which can be subject to higher volatility and lower liquidity compared to other investments as it can be impacted by a range of factors generally outside of the Group's control, such as economic conditions. Although not currently planned, the Group may in the future invest a portion of its assets in other asset classes, such as equities, which may carry more risk than existing asset classes.

The investment portfolios of the German and Italian businesses are held in instruments denominated in euros in order to match the currency of liabilities. In addition, the Group may in the future increase its investments in instruments denominated in euros as part of its general investment strategy, though as with US dollar denominated investments, the Group would seek to hedge most of its foreign exchange risk back to the denomination of the underlying liabilities.

As with its fixed income investments, any hedging or property designated as investment property held by the Group would be classified as financial assets at fair value. In the event of future currency fluctuation or property market declines, there can be no assurance as to the amount or timing of future realised losses or unrealised losses or impairments of the Group's investments, which may, in each case, adversely affect its business, prospects, results of operations and financial position.

Catastrophes, including natural disasters, may cause the Group to incur substantial losses

The Group is predominantly a personal lines insurer and, like all general insurance companies, it is subject to losses from unpredictable events that may affect multiple covered risks. In the United Kingdom, Italy and Germany, such events include both natural and man-made events, such as, but not limited to, windstorms, coastal inundation, floods, severe hail, severe winter weather, severe prolonged dry weather, other weather-related events, pandemics, large-scale fires, industrial explosions, earthquakes and other man-made disasters such as civil unrest and terrorist attacks.

The extent of the Group's losses from such catastrophic events is a function of their frequency, the severity of each individual event and the reinsurance arrangements the Group has in place. Some catastrophes, such as explosions, occur in small geographic areas, while others, including windstorms and floods, may produce significant damage to large, heavily populated and/or widespread areas. The Group generally seeks to reduce its exposure to such events by utilising selective underwriting and pricing practices, purchasing appropriate reinsurance, managing reinsurer concentration risk, excluding certain events under policy terms and conditions and participating in relevant government-sponsored schemes such as Pool Re, which offers reinsurance coverage for UK claims arising from terrorist attacks. However, its efforts to reduce its exposure, or appropriately price, or set appropriate underwriting terms for, its exposure may not be successful. In addition, government or industry schemes, such as those relating to flood control, are subject to change which could result in pricing risk if the Group is unable to price its products appropriately or result in reputational risk if the Group is suddenly forced to change its pricing or policy coverage.

The UK government has an agreement with the insurance industry, called the "Statement of Principles", that commits insurers to continue to offer flood insurance to existing customers where they are at significant risk and where the Environment Agency has announced plans and notified the Association of British Insurers of its intention to reduce that risk within five years. The current agreement is due to end in July 2013 and Defra is committed to ensuring that flood insurance remains widely available in England

after that date. However, there remains uncertainty as to the availability and cost of flood insurance post July 2013. Without additional action by the UK government it may be difficult to ensure the availability of flood insurance at a reasonable cost, particularly in light of the recent flooding over the summer of 2012, and it may be difficult to ascertain the overall impact on insurers. This risk depends in part on the government's commitment to spending on flood risk management including flood risk mapping and forecasting which would give insurers the ability to better predict the level of flood risk to individual properties.

The frequency and severity of catastrophes in general are inherently unpredictable and subject to long term external influences, such as climate change, and a single catastrophe or multiple catastrophes in any period could have a material adverse effect on the Group's business, prospects, results of operations and financial position.

The Group's business is concentrated in the United Kingdom

In the year ended 31 December 2011, the Group generated 91.8% of its total income in the United Kingdom, and in the six months ended 30 June 2012, the Group generated 91.0% of its total income in the United Kingdom. The Group is therefore particularly exposed to the economic, market, fiscal, regulatory, legislative, political and social conditions in the United Kingdom. In addition, the Group is exposed to the incidence and severity of catastrophic events in the United Kingdom, whether natural or man-made, and weather events, even if not rising to the level of catastrophes, can lead to volatility in the Group's results of operations due to concentration of its home insurance business in the United Kingdom.

The Group's investment portfolio is particularly exposed to changes in UK economic and market conditions, especially in relation to its exposure to sovereign debt and UK financial services-related debt. Economic conditions have been difficult and volatile in the United Kingdom since 2008, and any further deterioration in these conditions or a long-term persistence of these conditions could result in a downturn in new business and sales volumes of the Group's products, an increase in claims, and a decrease of its investment return, which, in turn, could have a material adverse effect on the Group's business, prospects, results of operations and financial position.

Difficult conditions in the global, European or UK economy may have a material adverse effect on the Group's business, results and financial condition

The Group's results are affected by conditions in the global economy, in the United Kingdom, Europe, the US and elsewhere around the world. Since the start of the global financial crisis in 2008, the global economy has been experiencing a period of significant turbulence. The outlook for the global economy over the near to medium term remains challenging and many forecasts predict only stagnant or modest levels of gross domestic product ("**GDP**") growth across the Group's markets (the United Kingdom, Italy and Germany) and continued low interest rates over that period.

The Group cannot predict the level of growth in the global economy, but it believes an ongoing sustained period of weak growth would have an adverse effect on its business, prospects, and results of operations. In addition, the fixed-income markets have experienced an extended period of volatility which has negatively impacted market liquidity conditions. Continuing market volatility may have an adverse effect on the Group, in part because it has a large investment portfolio and is also dependent upon customer behaviour. Even in the absence of a downturn in the global economy, the Group is exposed to risk of loss due to the impact of market volatility on its investment portfolio.

Factors such as inflation, consumer spending, business investment, government spending and the volatility and strength of both debt and equity markets all affect the business and economic environment and, ultimately, the amount and profitability of the Group's business. In the current economic downturn, characterised by higher unemployment, lower household income, lower corporate earnings, lower business investment, and lower consumer spending, the demand for the Group's insurance products has been and could continue to be adversely affected. In addition, in such circumstances, the Group may experience an elevated incidence or cost of claims, including higher claims inflation or fraudulent claims, as well as changes in accident rates, any of which could affect the current and future profitability of its business. A prolonged economic downturn could result in lower sales figures in the future as consumers may choose to reduce their insurance cover or purchases, defer buying or stop buying insurance altogether. These adverse changes in the economy could affect earnings negatively and could have a material adverse effect on the Group's business, prospects, results of operations and financial position.

Although a number of economies in Europe and elsewhere experienced a degree of recovery in 2010 and the first half of 2011, volatility of economic conditions increased in the second half of 2011 and has continued during 2012 as a result of the continuing uncertainty regarding the downgrade of sovereign debt ratings, the stability of numerous European banks and the ability of certain Member States, including Greece, Spain, Portugal, Italy, Ireland and Cyprus, to service their sovereign debt obligations resulting in downgrades in the ratings of such Member States by each of Standard & Poor's, Fitch, and Moodys (all credit rating agencies being registered in the EU) in the summer of 2012. This elevated risk of sovereign default by certain Member States and the heightened concerns regarding the contagion effect such a default would have on other EU economies has contributed to increased uncertainty regarding the future of the eurozone and the ongoing viability of the euro currency. While the long-term ratings of a majority of eurozone countries have already been downgraded as described above, further downgrades may occur. Economic growth in the eurozone as a whole is predicted to be negative in 2012 (Source: European Commission Press Release and IMF Press Release).

A break-up of the eurozone could have a significant impact on the Group's business, both from an investment and an operational perspective, although the nature and extent of any potential impact is unknown and very difficult to estimate, and would be dependent, in part, on the cause, timing and extent of any such break-up. A eurozone break-up could result in heightened counterparty risk as well as adversely affect the management of market risk and in particular asset and liability management due, in part, to redenomination of financial assets and liabilities. Should the scope and severity of the adverse economic conditions currently experienced by some Member States and elsewhere worsen, the risks faced by the Group would be exacerbated. Developments relating to the current economic conditions and unfavourable financial environment, including those discussed above, could have a material adverse effect on the Group's business, prospects, results of operations and financial position.

A sustained period of low interest rates or interest rate volatility could adversely affect claims settlements

The current economic environment could give rise to a sustained period of low interest rates or increased interest rate volatility, which could impact claims settlements and, as a result, the financial performance and overall capital position of the Group. Since the Ogden discount rate is used to calculate the present value of future costs or lost earnings in the cases of bodily injury or death, periods of sustained low interest rates or increased interest rate volatility could result in pressure from claimants to reduce the Ogden discount rate to compensate for lower or uncertain expected returns, thereby increasing the present value of those future costs and the value of lump sum payments owed to settle claims. Fear of low or volatile returns on claims settlements caused by low or volatile interest rates could also encourage more claimants to pursue PPO awards for bodily injury claims instead of lump sum awards. A decrease or an increase in the Ogden discount rate, which may come about as a result of the current review that has been commissioned by the Ministry of Justice, the Scottish Government and the Department of Justice, Northern Ireland or an increase in the propensity of PPO claims could increase the likelihood of a mismatch between the assumptions underlying the historical and future pricing of the Group's products and the actual claims and expenses experience. Further, if the current economic environment worsens, the Group would not only experience retrospective changes to its reserves, it may not be able to recover such future higher claims costs through higher prices, which could ultimately have a negative impact on the Group's current and future financial performance and, hence, potential capital requirements and/or held capital. Any such changes could adversely affect the Group's business, prospects, results of operations and financial position.

Reinsurance may not be available, affordable or adequate to protect the Group against losses, and reinsurers may dispute or default on their reinsurance obligations

As part of its overall risk mitigation and capital management strategy, the Group purchases reinsurance to cover certain risks to which it is exposed, such as a major weather related catastrophes through its home and commercial property businesses, business interruption in its commercial business, or single large vehicle-related incidents through its motor business. The Group's purchase of reinsurance reflects the insurance industry practice of reinsuring a portion of the risks it underwrites. Market conditions beyond the Group's control determine the availability and cost of appropriate reinsurance and the receipt of future reinsurance recoveries as well as the financial strength of reinsurers. Like insurance, reinsurance has been and may continue to be cyclical and exposed to substantial market losses, which may adversely affect reinsurance pricing and availability, or its terms and conditions. Similarly, risk appetite among reinsurers may change, resulting in changes in price or willingness to reinsure certain risks in the future. The Group

has material long term exposure to reinsurers in relation to its PPO claims provisions, where recoveries due from reinsurers in relation to such claims are estimated to occur significantly into the future, which increases the credit risk associated with such recoveries. Future changes in risk appetite and pricing by reinsurers may be particularly acute within motor reinsurance, where the increased propensity for awarding of PPOs to settle bodily injury claims, ambiguity over the recoverability for PPOs under reinsurance contracts written before PPOs developed and the uncertainty around any changes in the Ogden discount rate have already led to changes in the price and availability of reinsurance. Changes to reinsurance such as the removal of unlimited bodily injury cover also result in a mismatch between the insurer's legal requirements under the Road Traffic Act and reinsurance cover available. Any of these occurrences and/or significant changes in reinsurance pricing may result in the Group being forced to incur additional expenses for reinsurance, writing less business having to obtain sufficient reinsurance on less favourable terms or not being able to or choosing not to obtain reinsurance thereby exposing the Group to increased retained risk.

The Group purchases reinsurance under various agreements that cover defined blocks of business generally on a yearly renewable, per risk excess of loss or catastrophe excess of loss basis. These reinsurance agreements are designed to transfer risk and moderate the effect of losses to the Group. The amount of any particular risk that the Group decides to retain depends on an evaluation of the specific risk, and is therefore subject to uncertainty through the need to estimate likely future impact and, in certain circumstances, is subject to maximum limits based on the characteristics of coverage. Under the terms of these reinsurance agreements and in return for the premium paid, the reinsurer agrees to reimburse the Group for a portion of the claim paid to a policyholder and/or third-party claimant, or a portion of claims paid to a number of policyholders in the case of a catastrophic event. However, the insurance subsidiaries within the Group remain liable to their policyholders if any reinsurer fails to meet its reinsurance obligations, whether due to the reinsurer experiencing financial difficulties, a dispute over policy coverage between the Group and the reinsurer, or otherwise.

The Group's largest reinsurance providers are currently Swiss Re, Munich Re and General Re, which together underwrite a substantial portion of the Group's overall reinsurance programmes. While the Group has not previously been materially impacted by a default by a reinsurer, a default by a reinsurer to which the Group has material exposure, could expose the Group to significant losses and therefore have a material adverse effect on its business, prospects, results of operations and financial position.

The Group is exposed to counterparty risk, particularly in relation to other financial institutions including reinsurers

The Group is exposed to counterparty risk in relation to third parties in a number of ways, including but not limited to, holdings of fixed income instruments in its investment portfolios, its cash holdings, through reinsurance counterparties, policyholders, brokers, distribution partners and other supplier contracts.

The Group's business could suffer significant losses due to defaults on fixed income investments or defaults on interest payments, or the Group's reinsurers or other counterparties could fail to honour their obligations. Any losses from counterparties' failure to honour obligations and payments could have a material adverse effect on the Group's business, prospects, results of operations and financial position.

In the global financial system, financial institutions are interdependent, including with respect to reinsurers. The interdependence of financial institutions means that the failure of a sufficiently large and influential financial institution or other major counterparty (for example, a sovereign issuer), for whatever reason, could materially disrupt markets and could lead to a chain of defaults by counterparties. This risk, known as "systemic risk", could adversely impact the Group in many ways, some of which may be unpredictable, and may also adversely impact future sales as a result of reduced confidence in the insurance industry, difficulties encountered in clearing premiums and payments through the banking system or reduced ability or willingness to buy cover on the part of customers due to, for example, a customer not being able to obtain a mortgage, and adversely affect the Group's ability to recover from its reinsurance policies. The Group believes that, despite increased focus by regulators with respect to systemic risk, this risk remains part of the financial system and dislocations caused by the interdependence of financial market participants could adversely affect its business, prospects, results of operations and financial position.

The insurance business has historically been cyclical, experiencing periods of excess underwriting capacity and unfavourable premium rates and policy terms, and such cycles may occur again

Insurers have historically experienced significant fluctuations in operating results due to competition, the frequency or severity of catastrophic events, the levels of underwriting capacity, general social, legal or economic conditions and other factors. The supply of insurance capacity is related to prevailing prices, the level of insured losses and the level of industry profitability and capital surplus which, in turn, may fluctuate in response to changes in inflation rates, the rates of return on investments being earned by the insurance industry, as well as other social, economic, legal and political changes. As a result, the insurance business has historically been cyclical, characterised by periods of intense competition in relation to price and policy terms and conditions often due to excessive underwriting capacity, as well as periods when shortages of capacity have seen increased premium rates and policy terms and conditions that are more advantageous to underwriters. Increases in the supply of insurance (whether through an increase in the number of competitors, an increase in the capitalisation available to insurers, or otherwise) and, similarly, reduction in consumer demand for insurance, could have adverse consequences for the Group, including fewer contracts written, lower premium rates, increased expenses for customer acquisition and retention, and less favourable policy terms and conditions for the Group, any of which could adversely affect its business, prospects, results of operations and financial position.

The Group is required to maintain significant levels of capital and to comply with a number of regulatory requirements relating to its operations, solvency and reporting bases

The Group and its insurance and other regulated subsidiaries are required to maintain a significant margin of solvency in excess of the value of their liabilities to comply with a number of regulatory requirements relating to the Group's and such subsidiaries' solvency and reporting bases. These regulatory requirements apply to individual insurance subsidiaries on a stand-alone basis and in respect of the Group as a whole. The amount of regulatory and economic capital required also depends on the level of risk facing the insurance and other subsidiaries in the Group, and as such correlates to economic and general insurance market cycles. As at 30 June 2012, on an Insurance Groups Directive basis, the Group's Insurance Groups Directive ("**IGD**") coverage ratio was 305.9%, having been reduced from 319% as at 31 December 2011 as a result of the capital management actions taken in the first half of 2012, see Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Key Strengths—Robust balance sheet, with prudent capital management approach*". However, the regulatory regime governing capital and solvency is currently in the process of changing, see "*—The European Union is currently in the process of introducing a new regime governing solvency requirements, technical reserves, and other requirements for insurance companies, the effect of which is uncertain*".

The Group's capital position can be adversely impacted by a number of factors, in particular, factors that erode the Group's capital resources and which could impact the quantum of risk to which the Group is exposed. In addition, any event which erodes current profitability and is expected to reduce future profitability and/or make profitability more volatile could impact the Group's capital position, which in turn could have a compounding or pro-cyclical negative effect on the Group's results of operations.

The Board is responsible for managing the capital position of the Group. In the event that regulatory capital requirements are, or may be, breached, the supervisory authorities are likely to require the Group or any of its regulated subsidiaries to take remedial action, which could possibly include measures to restore the Group's or the individual subsidiary's capital and solvency positions to levels acceptable to such authorities, for the purposes of ensuring that the financial resources necessary to meet obligations to policyholders are maintained. In addition, for a variety of reasons including the recent economic downturn, the risk profile of peer companies of the Group and the industry as a whole, and the specific current or potential future risk profile of the Group's individual businesses as well as the strategic initiatives that have recently been taken or identified by the Group (or which are taken or identified in the future), either the Board could decide to hold higher surplus above regulatory capital or the supervisory authorities could decide to increase the regulatory capital requirements of any of the Group's regulated subsidiaries, and the Group overall.

If the Group is unable to meet applicable regulatory capital requirements in any of its regulated subsidiaries, it would have to take measures to protect its capital and solvency position, which might include redeploying existing capital from elsewhere in the Group, increasing prices, reducing the volume of or types of business underwritten, increasing reinsurance coverage or divesting parts of its business, any of which may be difficult or costly or result in a significant loss, particularly in cases where such measures are required to be undertaken quickly.

The Group might also have to raise additional capital in the form of debt or equity to meet existing or future regulatory capital requirements. Raising additional capital from external sources might be possible only on unfavourable terms or not at all, due to factors outside the Group's control, such as market conditions. In addition, the Group and its regulated subsidiaries might have to reduce the amount of dividends they pay to their respective shareholders, or possibly cease paying any dividends to meet their regulatory capital requirements.

If the regulatory capital requirements are not met (because the Group could not take appropriate measures or because the measures were not sufficiently effective), the Group could lose key licences and hence be forced to cease some of its insurance and/or business operations. In such circumstances, the Company would not be allowed to pay dividends, and the Group may be limited in its ability to draw upon the resources of, or satisfy intra-group arrangements with respect to its regulated subsidiaries. Any of these measures could have a material adverse effect on the Group's business, prospects, results of operations and financial position. In an extreme scenario (which the Board considers highly unlikely), where external equity and debt capital cannot be raised, even on unfavourable terms, and where all other remedial actions are insufficient to meet regulatory requirements, the Group could be required to run off all of its business, which would result in the Group no longer being able to operate.

The Group is subject to extensive regulatory supervision, including requirements to maintain certain licences, permissions and/or authorisations, both in the United Kingdom and internationally

The Group's insurance subsidiaries in the United Kingdom, Germany and Italy are subject to detailed and comprehensive government regulation and legislation (see generally Part IX: "*Regulatory Overview*"). Regulatory agencies have broad powers over many aspects of the insurance business, which may include marketing and selling practices, advertising, licensing agents, product development and structures, premium rates, policy forms, claims and complaint handling practices, data and records management, systems and controls, capital requirements and adequacy, and permitted investments. For example, in the United Kingdom the FSA has the power to make enquiries of the companies it regulates regarding their compliance with regulations governing the operation of businesses, and the Group faces the risk that the FSA might find that it has failed to comply with applicable regulations or has not undertaken corrective action where required. Government regulators are concerned primarily with financial stability and the protection of policyholders and third-party claimants rather than the Group's shareholders or creditors, and have been giving increasing attention to consumer issues and the overall fairness of insurance products. Insurance and non-insurance laws, regulations and policies currently affecting the Group, and the approach and attitude of insurance regulators may change at any time in ways which have an adverse effect on the Group's business.

In order to conduct business in the jurisdictions in which the Group currently operates, it must obtain and maintain certain licences, permissions and authorisations (such as permission from the FSA to conduct insurance activities in the United Kingdom under Part IV of the FSMA) and must comply with rules and regulations as determined by these jurisdictions. Failure to comply with the promulgated regulations, applicable insurance laws and public approvals and policies may lead to legal or regulatory disciplinary action, the imposition of fines or the revocation of licences, permissions or authorisations, which could have a material adverse impact on the Group's continued conduct of business in that jurisdiction.

In addition to consumer protection measures imposed on the Group by financial services regulators, the Group is also subject to competition and consumer protection laws enforced by the Office of Fair Trading ("**OFT**"), the UK Competition Commission and the European Competition Commission, such as laws relating to consumer credit as well as price fixing, collusion and other anti-competitive behaviour in the United Kingdom. For example, the OFT published a report on its market study into private motor insurance on 31 May 2012. On 28 September 2012, the OFT confirmed its May decision to refer the UK market for the supply or acquisition of private motor insurance and related goods or services to the Competition Commission. The Board cannot predict with any certainty the effect that this decision may have on the Group. See Part IX: "*Regulatory Overview—Regulatory developments*" for further information.

In addition, the Group, like many other financial institutions, has come under greater regulatory scrutiny in recent years and expects similar conditions to continue for the foreseeable future, particularly as it relates to compliance with new and existing corporate governance, employee compensation, conduct of business, product governance, anti-money laundering, anti-terrorism and sanctions laws and regulations, as well as the provisions of applicable sanctions requirements (see Part IX: "*Regulatory Overview—Anti-money laundering, anti-terrorism and sanctions laws and regulations*"). Regulatory investigations and/or enforcement actions against the Group in relation to anti-money laundering, anti-terrorism and sanctions

laws or regulations could result in fines, other sanctions, including payments with respect to liabilities relating to historical business, and immediate reputational and regulatory risks, and materially adversely impact its business, prospects, results of operations and financial position.

Changes in both the regulatory requirements that apply to the Group, such as prudential rules on capital adequacy frameworks or conduct rules and their application, and the approach and/or architecture of national and/or EU financial services regulators (particularly a principles-based approach to compliance), may result in an increased number of regulatory investigations and actions. Further, the insurance and wider financial services industries face a number of regulatory initiatives aimed at addressing lessons learned from the financial crisis and other industry-level issues such as payment protection insurance mis-selling (see Part IX: "*Regulatory Overview—Regulatory developments*" and Part XII: "*Operating and Financial Review—Key Factors Affecting Results of Operations—Regulatory and Legal Developments*"). In addition, new UK regulatory bodies are in the process of being established and the proposals on how they will operate are still to be approved by the UK Parliament (see "*—Changes in laws, regulations, government policies and their enforcement and interpretations could adversely affect the Group*"). It is likely that the changes will impact how the Group will interact with its financial services regulators going forward. While the Group will seek to ensure that it is prepared for this new system of regulation, there are additional risks associated with the uncertainty over how the new financial services regulators intend to apply their new powers and whether the new system will result in more intrusive and intensive regulation or supervision and/or changes in business practices, including remuneration policies adding additional burdens on the Group's resources and further compliance risk. Any change in regulatory focus in the United Kingdom or European Union on product regulation may also have an impact on the Group's ability to sell certain products in the future, which may adversely affect the Group and its distribution arrangements. The Group could be impacted by these regulatory changes as well as other global initiatives, European initiatives and national initiatives in the markets within which it operates.

The Group's businesses in Italy and Germany are regulated by local regulators that have broadly similar powers to those in the United Kingdom, and could therefore have a similar negative impact on the Group's reputation or business. Regulatory action, whether arising from EU, UK or other local laws and regulations, against a member of the Group or a determination that the Group has failed to comply with applicable regulation, including, without limitation, any of the examples discussed herein, could result in fines and losses as well as adverse publicity for, or negative perceptions regarding, the Group, which in turn could have an adverse effect on the Group's business, prospects, results of operations and financial position, or otherwise divert management's attention from the day-to-day management of the business, potentially impacting its ongoing or future performance.

Changes in laws, regulations, government policies and their enforcement and interpretations could adversely affect the Group

The Group will not always be able to predict accurately the impact on the Group's business, prospects, results of operations and financial position of future legislation or regulation or changes in the enforcement, interpretation or operation of existing legislation or regulation. Changes in government policy, legislation or regulatory interpretation or enforcement (at a national and/or EU level) applying to companies in the financial services and insurance industries in any of the markets in which the Group operates may be applied retrospectively, and may adversely affect the Group's underlying profitability, its product range, distribution channels, capital requirements and, consequently, results and financing requirements. Examples of recent or future legislation or regulation include the reorganisation of the FSA into two successor bodies, the Prudential Regulation Authority and the Financial Conduct Authority, reorganisation of ISVAP, the implementation of gender-neutral pricing at the end of 2012, the impact of historical and future changes in the Financial Services Compensation Scheme in the United Kingdom, including the risk of failure in other financial services sectors impacting the levies on insurers, changes by the UK Motor Insurers' Bureau with respect to vehicles declared "off the road", the proposed banning of legal referral fees, amendments to discount rates and applications of PPOs, the OFT motor insurance market study, proposed amendments to UK insurance contract law, potential regulation to ban the use of auto-renewal insurance contracts, potential regulation to change the manner whereby motor legal expenses insurance and family legal expenses insurance are sold, government initiatives to improve transparency and customer confidence in insurance pricing, changes to regulations requiring customers to report past crimes to insurers and new EU solvency requirements.

Legislation and regulation recently proposed and enacted in the United Kingdom such as the introduction of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 ("**LASPO**") and other reforms to

costs in the English civil litigation system proposed by Lord Justice Jackson, including a 10% increase in general damages, have the propensity to increase as well as reduce the Group's income and costs. Taken together, the Group currently believes that these proposed reforms if implemented in a coordinated manner, should have a broadly neutral effect on the results of the Group in the medium term although the short term impact of some reforms (such as the banning of referral fees) may have an adverse effect on the Group's results before the benefits of other reforms (such as reduction in fixed legal fees) are realised by the Group. See Part XII: "*Operating and Financial Review—Regulatory and legal developments—Civil litigation costs reform in England and Wales*". If, however, certain of these reforms are adopted on a piecemeal or uncoordinated basis, these reforms could have an adverse effect on the Group's results.

A specific recent example of this, which may have an incremental adverse impact on the Group's results in the short term, is the decision in July 2012 of the Court of Appeal in *Simmons v. Castle* ([2012] EWCA Civ 1039). The Group had previously anticipated that a 10% increase in general damages, as recommended by Lord Justice Jackson, would apply to new claims commenced after 1 April 2013 but with certain other offsetting measures to be implemented by LASPO coming into effect at or around the same time. However, the Court's decision implemented a 10% increase in general damages with effect from 1 April 2013 but applied it to all claims decided after that date, irrespective of when the claim was made. As a result, claimants for recoverable claims commenced before 1 April 2013 but settled or decided after 1 April 2013 would be entitled to recover a success fee and after-the-event premiums and additionally a 10% increase in the amount of general damages.

There is currently uncertainty arising from the Court of Appeal's decision in *Simmons v. Castle* in July 2012 and a subsequent hearing on 25 September 2012, following applications by the ABI to the Court of Appeal for it to reconsider its decision. The outcome of the recent hearing is pending as at the date of this Prospectus and, as such, the impact on cost of claims for the industry is unclear. If the Court declines to amend its July decision, and assuming its decision is handed down in the near future, the Group currently estimates that this could result in an adverse pre-tax impact in the region of approximately £30 million to £45 million to the Group's results in 2012, the majority of which may be recognised in the third quarter of 2012. If the Court reverses its original decision, this impact will not arise, although it is also possible that the Court may implement a compromise position, which would result in a lesser impact. Given the current uncertainty, the above estimates do not include mitigating actions, if any, that may be available to the Group.

The financial consequences of any such change cannot be estimated before further detail becomes available. In addition, new powers will be introduced allowing the Financial Conduct Authority to intervene to ban new products and review insurance distribution models, which could impact the Group's ability to sell certain products and/or reduce their expected profitability, or may involve significant liabilities in relation to historical business underwritten by the Group and/or the industry as a whole. At the EU level, the European Parliament recently created the European Insurance and Occupational Pensions Authority, which will have extended powers to develop the detailed aspects of the Solvency II regime (see "*—The European Union is currently in the process of introducing a new regime governing solvency requirements, technical reserves, and other requirements for insurance companies, the effect of which is uncertain*"), regulate marketing activities and provide guidelines and recommendations to national supervisors, including those in the United Kingdom. The new regulatory bodies in the United Kingdom and European Union are still in the process of being established, and it remains unclear how any of them will apply their powers or how the application of their powers may impact the Group. For further information, see Part IX: "*Regulatory Overview—Regulatory developments*".

The Group's technical reserves are exposed to retrospective and prospective legal changes through court awards and other changes, such as the impact of a potential change in the Ogden discount rate used to calculate lump sum awards, allowance of a new head of claim or type of claim, and other inflationary trends. In addition, changes in the enforcement of laws, regulations or government policies as a result of political developments, worsening economic conditions or, in certain cases, introduction of government austerity measures, or otherwise, could result in an increase in the frequency or quantum of fines or other adverse government intervention, and, in turn, reputational and other adverse impacts to the Group's business. The Group may also face increased compliance costs due to such changes to financial services legislation or regulation, or due to the need to set up additional compliance controls. Any such changes could have a material adverse effect on the Group's business, prospects, results of operations and financial position.

The European Union is currently in the process of introducing a new regime governing solvency requirements, technical reserves, and other requirements for insurance companies, the effect of which is uncertain

The European Union is in the process of developing and implementing a new regime in relation to solvency requirements and other matters, affecting the financial strength of insurers and reinsurers ("**Solvency II**") within each Member State. It is intended that the new regime for insurers and reinsurers domiciled in the European Union will apply more risk sensitive standards to capital requirements, bringing European insurance regulation more closely in line with banking and securities regulation with a view to avoiding regulatory arbitrage, aligning regulatory capital with economic capital, and enhancing public disclosure and transparency. As a result, the general treatment of capital is likely to change, and the Group's existing and future capital resources may not meet Solvency II requirements in either form or amount.

In addition to new capital requirements and procedures, the Solvency II regime is also expected to require changes to business operations, including the organisation of, input to, and output from internal processes, the roles and responsibilities among certain key officers, and external reporting obligations, both to the regulator and the public. The significant changes to the presentation of financial information for insurers on a Solvency II basis also poses increased risk of misinterpretation by the market, third parties, stakeholders and consumers. While the overall intentions and process for implementing Solvency II are known, the future landscape of EU solvency regulation is still evolving, and the precise interpretation of the rules is still being developed. See Part IX: "*Regulatory Overview—Regulatory developments—The new EU solvency regime for insurance companies*".

The European Parliament and Council of the European Union approved the directive containing the framework principles of Solvency II on 22 April 2009 and 10 November 2009, respectively. At present, it is expected that each Member State will be required to implement the new rules by 30 June 2013, with the regime becoming binding on insurers and reinsurers within each Member State from 1 January 2014, although uncertainty still remains as to whether these timelines will be achieved.

The Group intends to use an internal model, which it designed specifically for use with its business, to determine its regulatory capital requirement under Solvency II in relation to U K Insurance, its main UK regulated general insurance entity (which, following the Group's reorganisation of its UK regulated general insurance subsidiaries in 2011, underwrites a substantial majority of the Group's UK general insurance business). The Group's intention is that the internal model for U K Insurance will cover all risks except potentially operational risk, where it may use the standard formula prescribed by Solvency II for regulatory capital. The Group's intention is to use the standard formula for its other regulated insurance entities, potentially using "undertaking specific parameters" as part of that formula.

While the Group has been using its own methodology to calculate regulatory capital for a number of years in relation to its UK entities, this methodology is being reviewed and adjusted by the Group for U K Insurance to ensure it will be compliant with Solvency II requirements. This includes implementation of new processes to calculate technical reserves and the Group's resultant balance sheet under Solvency II requirements.

The ability of the Group to use an internal model for the purposes of calculating the capital requirement applicable at the level of U K Insurance, which will impact the Group's overall capital requirement, is subject to supervisory approval of the internal model in advance of the implementation of Solvency II. The nature and approach to such approval is extensive and complex, and significant elements of the underlying implementing measures and regulatory guidance associated with the new regulation are still uncertain. Given the nature and scope of changes required to the Group's internal systems and processes as a result of Solvency II, there is a risk that approval for live running of the internal model for U K Insurance could be delayed. Less time for live running of the model generally increases the risk of not achieving timely final internal model approval or the denial of such final approval.

The Group intends to use the standard formula to assess and determine the regulatory capital requirements for its life insurance business and its insurance operations in Germany and Italy. This will similarly pose risks to those entities from both capital requirements and business operations perspectives. Further, the Group's Italian and German entities may also apply to use "undertaking specific parameters" as part of the standard formula. These parameters would generally serve to reduce the capital requirements under the standard formula. If the relevant Italian or German regulators (*Instituto per la Vigilanza sulle Assicurazioni Private di Interesse Collettivo* ("**ISVAP**") and *Bundesanstalt für Finanzdienstleistungsaufsicht* ("**BaFin**"), respectively) deny the use of these parameters, the capital requirement for these entities may be higher than anticipated.

Failure by U K Insurance to achieve regulatory approval for the use of its internal model, or failure by the Group's Italian and German entities to achieve regulatory approval for the use of "undertaking specific parameters" could result in an increase to the amount of capital resources that the Group and/or its insurance subsidiaries would be required to maintain under Solvency II.

Given the uncertainty surrounding the requirements of Solvency II, including the date of its implementation, there can be no assurance that the Group will not need to strengthen its solvency capital position or modify its business operations and processes if and when Solvency II enters into force, even if the Group receives approval of its internal model. There are also risks that the Group's regulated entities may not make such changes in an appropriate and timely manner, which may result in wider regulatory action or censure over and above action relating to model approval and capital requirements including, but not limited to, capital add-ons for one or more of the Group's regulated entities. Any such imposition, including the failure to achieve internal model approval for U K Insurance, could result in negative publicity for the Group and/or its insurance subsidiaries and other adverse impacts to the Group's business, such as reduced sales volumes, contractual difficulties and a downgrade in the credit rating of U K Insurance.

To the extent that the regulatory capital requirement under Solvency II is higher than that required currently, depending on the size of any capital surplus, there is a risk that the Group may need to raise additional capital, resulting in further exposure to the risks relating to capital requirements described in "*—The Group is required to maintain significant levels of capital and to comply with a number of regulatory requirements relating to its operations, solvency and reporting bases*", which could have a material adverse effect on the Group's business, prospects, results of operations and financial position.

Litigation and regulatory investigations and sanctions may have a material adverse effect on the Group

The Group faces significant risk of litigation and regulatory investigations and actions in the conduct of its business, including by the FSA and/or its successor organisations, the OFT, the Financial Ombudsman Service, ISVAP and BaFin as well as commercial disputes with counterparties. In recent years, the financial services industry and financial products have increasingly been the subject of litigation, investigation and regulatory activity by various governmental, supervisory and enforcement authorities. Such litigation and investigations have involved common industry practices such as the disclosure of contingent commissions, referral fees, and the sale and ongoing handling of payment protection insurance policies, and may also arise out of regulatory self reporting obligations with respect to issues such as operational errors or loss of customer data, any of which could result in significant fines and/or other costly sanctions, or cause damage to the brands or reputations. For example, in the beginning of 2012, the FSA imposed a £2.17 million fine on the Group in relation to complaint file alterations.

The Group cannot predict the effect that the current trend towards increased litigation and investigation will have on its business or the broader insurance or financial services industries. Current and future investigations by supervisory authorities could result in sanctions, require the Group to take costly measures or result in changes in laws and regulations in a manner that is adverse to the Group and its business. By way of example, the Group recently identified and continues to analyse certain policy administration issues regarding incorrect refunds for motor policies affecting approximately 400,000 customers between 2005 and 2011. The Group first reported the issue to the FSA in February 2011, and has ongoing dialogue on the issue with the FSA. The Group has begun making refund payments to customers, and expects to complete that process in the near term. While the Group does not currently believe that this issue will result in any further action by the enforcement division of the FSA, it or other instances of a similar nature could lead to such action. Changes to the pricing or structure of any products resulting from legal or regulatory action, a substantial legal liability or a significant regulatory action could have a material adverse effect on the Group's business, prospects, results of operations and financial position. In addition, the Group's reputation could suffer, it could be fined or prohibited from engaging in its business activities or be sued by customers or other third parties if it does not comply with applicable laws, regulations or contractual obligations. It is inherently difficult to predict the outcome of many of the pending or potential future claims, regulatory proceedings and other adversarial proceedings involving the Group.

Inconsistent application of directives by regulators in different Member States may place the Group's business at a competitive disadvantage

Insurance regulation in the United Kingdom is largely based on the requirements of EU directives. Inconsistent application of directives (including Solvency II) by regulators in different Member States may place the Group's business at a competitive disadvantage to other European financial services groups. In

addition, changes in the local regulatory regimes of Member States in which the Group operates could affect the calculation of the Group's solvency position and other matters. While the aims of Solvency II are to introduce a harmonised, risk-based approach to solvency capital, there is a risk of differences in interpretation and a failure by financial services regulators to align Solvency II approaches across Europe, resulting in an unequal competitive landscape, with potentially adverse effects on the Group's business, prospects, results of operations and financial position.

The Group is exposed to particular risks specific to motor insurance

Motor insurance is the Group's largest product line by volume of in-force policies and gross written premiums, and represents a core component of the Group's overall business going forward. UK motor insurance represented 42.1% of total ongoing gross written premiums during the year ended 31 December 2011 and 40.9% for the six months ended 30 June 2012. While many of the risks inherent to the sale and administration of motor insurance are similar to all general insurance business lines, and are therefore discussed in greater detail elsewhere in this section, "*—Risks relating to the Group*", there remain several risks that are more relevant or even specific to this product, the material risks being:

- Increased propensity of severe bodily injury claims to settle using PPOs, which exposes the Group to further earnings-related inflation as well as additional mortality, investment income and reinsurance credit risks.
- Increased bodily injury or third-party property damage claims, which could be caused by, among others, an increased propensity of third parties to claim, increased size or severity of claims, and increased fraud associated with staged accidents, falsified claims or other fraudulent reporting.
- Enhancements in medical knowledge and techniques as well as the increasing use of rehabilitation, resulting in increased life expectancy for (severely) injured claimants, with expensive medical and rehabilitation regimes required for longer periods.
- The potential for one or more global reinsurers in the future to fail, change their risk appetite and/or alter the nature or terms of their reinsurance cover, such as removing unlimited bodily injury cover.
- Uncertainty of the outcome or impact of potential regulatory or legislative changes (including, but not limited to, the abolition of certain referral fees) as a result of either current investigations and initiatives or potential future initiatives (see Part IX: "*Regulatory Overview—Regulatory developments*").
- The exposure of motor insurance reserves to retrospective and prospective legal changes through court awards and other changes, such as the impact of a reduction in the Ogden discount rate used to calculate lump sum awards, and other inflationary trends.
- Significant competition among motor insurers, including potential new entrants, and an increasing propensity for customers to use price comparison websites ("**PCWs**") (see "*—The Group is exposed to further changes in the competitive landscape including increased competition from other distribution channels, in particular PCWs, the long-term implications of which are not yet fully understood*").
- Changes in the frequency of motor accidents due to potential changes in the economy, changes in fuel prices and technological changes to vehicles and roadways and other reasons.

The occurrence or persistence of any of these factors could have a material adverse effect on the Group's business, prospects, results of operations and financial position.

The Group is exposed to foreign exchange rate risk

The British pound sterling is the Group's presentation currency. The Group, however, does enter into insurance contracts under which the premiums receivable and substantially all losses payable are denominated in euro. To manage foreign exchange risk on those contracts, the Group holds reserves for those contracts in euro. In addition, the Group's travel, motor and certain other insurance policies may be exposed to foreign exchange risk on claims or losses incurred outside of the United Kingdom.

When the Group incurs a liability in a foreign currency, it carries such liability on its books in the original currency. These liabilities are converted from the respective foreign currency into sterling on each balance sheet date. At the same time, assets in the same amount are generally held unhedged on the balance sheet for each currency. In general, however, there is no exact match between assets and liabilities in each

currency. The unrealised losses or gains on foreign currency exchange rates are reflected either in the Group's income statement or within other comprehensive income. The Group may incur foreign currency exchange gains or losses as it ultimately receives premiums or settles claims payable in foreign currencies. Furthermore, a breakup of the eurozone (partial or otherwise) could result in a mismatch in currencies between assets and liabilities for the Group's businesses, and such mismatches could be difficult to hedge. See "*—Difficult conditions in the global, European or UK economy may have a material adverse effect on the Group's business, results and financial condition*".

As discussed in relation to the Group's investment portfolio, the Group is currently in the process of diversifying its investment portfolio to include instruments denominated in US dollars and potentially other currencies, including the euro. While the Group currently intends to hedge most of its foreign exchange risks in the future, if those hedges prove ineffective or are not entered into, or there is a counterparty default, the impact of fluctuations in foreign currency exchange rates could adversely affect its business, prospects, results of operations and financial position.

The Group is exposed to the risk of damage to its brands, the brands of its distribution partners and its reputation

The Group's success and results are dependent on the strength and reputation of the Group and its brands. The Group and its brands are vulnerable to adverse market perception as it operates in an industry where integrity, customer trust and confidence are paramount. The Group relies on its principal brands, Direct Line and Churchill, but is also dependent on its other brands, such as Privilege and NIG, and its distribution partner brands, such as RBS/NatWest, Nationwide, Sainsbury's and Prudential. The Group is exposed to the risk that litigation, employee misconduct, operational failures, the outcome of regulatory or other investigations or actions, press speculation and negative publicity, amongst others, whether or not founded, could damage its brands or reputation. Any of the Group's brands or the Group's reputation could also be harmed if products or services sold by the Group (or any of its distribution partners or intermediaries on behalf of the Group) do not perform as expected (whether or not the expectations are founded) or customers' expectations for the product change.

Negative publicity could result, for instance, from an allegation or determination that the Group has failed to comply with regulatory or legislative requirements, from failure in business continuity or performance of the Group's information technology systems, loss of customer data or confidential information, fraudulent activities, unsatisfactory service and support levels or insufficient transparency or disclosure of information. Further, damage to the reputation of any of the Group's non-insurance products or companies, could negatively affect the reputation of the Group's insurance brands. Similarly, damage to any of the Group's individual brands could limit the Group's ability to cross-sell those products in line with its strategy. Negative publicity adversely affecting the Group's brands or its reputation could also result from misconduct or malpractice by outsourcing partners, both in local territories or off-shore, intermediaries, business promoters or other third parties linked to the Group (such as strategic partners, distributors and suppliers). In addition, because of its relationship with the RBS Group, negative publicity about the RBS Group could have a negative effect on the Group. Further, to the extent that negative publicity or reputational damage to the Group impacts one of the Group's partners, either in terms of reputational damage or sales of its products, the Group may be liable for contractually based fines or damages payments to such parties.

Any damage to the Group's brands or reputation could cause existing customers, partners or intermediaries to withdraw their business from the Group and potential customers, partners or intermediaries to be reluctant or elect not to do business with the Group. Such damage to the Group's brands or reputation could cause disproportionate damage to the Group's business, even if the negative publicity is factually inaccurate or unfounded. Furthermore, negative publicity could result in greater regulatory scrutiny and influence market or rating agencies' perception of the Group, which could make it more difficult for the Group to maintain its credit rating. The occurrence of any of these events could have an adverse effect on the Group's business, prospects, results of operations and financial position.

The Group has a number of strategic distribution partnerships that are material to its business

The Group has entered into various strategic distribution partnerships that are important to the marketing, sale and distribution of its products, and sells insurance under a number of key partner brands, the most important of which include Prudential, RBS/NatWest, Nationwide and Sainsbury's. The Group's distribution partnerships with RBS/NatWest (which has been formalised on an arm's length basis prior to the publication of this Prospectus), Nationwide and Prudential accounted for a substantial portion of gross written premiums for its home business in 2011. The Group continues to consider other strategic distribution partnerships both in the United Kingdom and in its international businesses.

The Group's distribution partners are operationally independent of the Group. The Group's distribution agreements tend to be long term, and as a result the Group may not be able to exit potentially disadvantageous contracts in a timely manner or without significant expense. In addition, several of the Group's distribution agreements are due to expire in close succession, which could result in a disproportionate adverse impact to the Group's distribution business if its partners do not seek to renew on similar terms, or at all. Growth in distribution business may potentially result in a reduction in customers of the Group's proprietary brands and diminish the long-term benefits of those customer relationships, particularly in its home business.

The Group's distribution partnerships could be terminated as a result of a variety of events, including breach of contract, disagreement between the Group and its partners, a downgrade in the Group's credit rating and counterparty insolvency. The business generated through the Group's distribution partnerships could also be adversely affected by adverse changes to the Group's reputation or the reputation of its partners or changes in the business strategy of its partners, particularly if a partner chose to exit the general insurance business altogether. Termination of, or any other material change to, the Group's relationships with its partners could adversely affect the sale of its products and its growth opportunities in the United Kingdom and elsewhere, and could therefore have an adverse effect on its business, prospects, results of operations and financial position. Termination of, either current or past, distribution relationships can also result in disputes over the dissolution or final settlement of distribution agreements, which can potentially lead to litigation and, further, the Group could be required to fulfil its partner obligations in the event of the termination of a relationship. The distribution agreements also include various requirements on the Group, and the Group may have to pay significant fines or damages under the arrangements if it fails to fulfil these obligations. The terms and conditions of the Group's agreements with partners are also subject to change from time to time, and the Group may be unable to renew its agreements with partners on similar terms, or at all.

Regulatory and other developments can have an impact on how the Group manages these distribution partnerships and/or their expected financial performance. Industry-wide considerations, such as the sale of payment protection insurance products and packaged bank accounts (where the Group's products may be sold as part of a suite of benefits for the holder of that account) may result in new rules and regulation on the sale of these products. The outcome of these changes could force the Group and its partners to reassess their respective responsibilities and the overall pricing and packaging advantages to their products, which could adversely affect the strategic importance of these distribution channels.

Downgrades of or the revocation of the Group's financial strength credit ratings could affect its standing in the market, result in a loss of business and reduce earnings through increased costs of borrowing

U K Insurance, the Group's principal UK general insurance underwriter, has been assigned an insurer financial strength rating of "A" with a stable outlook by Standard & Poor's and "A2" with a stable outlook by Moody's, as last confirmed on 7 March 2012, and 2 May 2012, respectively. Members of the Group may have other ratings assigned by other rating agencies in the future. Both credit rating agencies are registered in the EU. U K Insurance's insurer financial strength ratings are subject to periodic review by, and may be revised downward or revoked at the sole discretion of, Standard & Poor's and Moody's. Even though the Company was not affected by the recent downgrade of the RBS Group, for so long as the Company remains a part of the RBS Group, the rating of U K Insurance could be impacted by any change to the overall rating of the RBS Group. In particular, Standard & Poor's and Moody's currently link the financial strength ratings of U K Insurance to the overall rating of the RBS Group. As a consequence, Standard & Poor's has indicated that its rating for U K Insurance could be affected by future rating actions on the RBS Group by Standard & Poor's, while Moody's has indicated that its rating for U K Insurance could be negatively impacted by a material weakening of the RBS Group's credit profile as reflected in any further downgrade in the RBS Group's ratings or any delay to the divestment of the Company from the RBS Group.

Standard & Poor's and Moody's are each credit rating agencies established in the European Union and registered under Regulation (EC) No 1060/2009 and each of them is included in the list of credit rating agencies published by the European Securities and Markets Authority on its website in accordance with such Regulation. The ratings assigned by the rating agencies are neither an evaluation directed towards investors in the Ordinary Shares nor a recommendation to buy, sell or hold the Ordinary Shares.

Any downgrade in or revocation of U K Insurance's ratings may adversely affect the Group's liquidity and the cost of raising capital or cause the Group to incur additional financial obligations. Furthermore, downgrade or revocation could have a negative impact on the Group's public reputation and competitive

position in the market, especially in relation to its distribution arrangements and commercial business where partners or customers may not be willing or permitted to place their insurance with a lower rated insurer, which could result in reduced business volumes and income. The occurrence of any of the above could have an adverse effect on the Group's business, prospects, results of operations and financial position.

The Group faces significant competition from other insurance companies and others

The Group faces significant competition (current and future) from domestic insurers, other international insurance groups and others (in any such case whether established or new entrants to the market or start-up operations) in each of the Group's principal markets, which offer or may in the future offer the same or similar products and services as the Group. The Group operates in markets in which the most important competitive factors for general insurance products include brand recognition, the utilisation of various distribution channels, product price, the quality of customer services before and after a contract is entered into (including claims handling), product flexibility, product innovation and policy terms and conditions. The entry into, or the targeting of, the markets in which the Group operates, particularly the UK, by international insurers with greater financial resources or the ability to charge lower prices could adversely affect the Group's ability to obtain new, or retain existing, customers, or its ability to adjust prices.

If the Group is unable or is perceived to be unable to compete effectively within its core markets or products, its competitive position may be adversely affected. In particular, competitive pressures may, among other things, compel the Group to reduce prices, which may adversely affect its operating margins, underwriting results and capital requirements, or reduce its market share, any of which could have an adverse effect on its business, prospects, results of operations and financial position.

The Group is exposed to further changes in the competitive landscape including increased competition from other distribution channels, in particular PCWs, the long-term implications of which are not yet fully understood

Competition for general insurance products continues to intensify through the development of alternative distribution channels, such as PCWs (for example, Comparethemarket.com, Gocompare.com and recently-launched price comparison features on Google), which originated 57% of new business in the UK motor insurance market in 2011. PCWs are intermediaries that present multiple insurance quotes to a given buyer, allowing the buyer to make a comparison between insurance offerings based on a single set of information provided to the PCW. In recent years, a substantial and generally increasing amount of new general insurance policies has been sold through PCWs, particularly motor insurance.

Though the long-term implications of the growth in PCWs cannot be fully predicted, the Group expects the increasing use of PCWs to result in a greater incidence of Group brands acquiring new customers from other Group brands, increasing overall acquisition costs and potentially reducing the profitability of the business written due to lower or eliminated margins. See also "*—Changes to customers' behaviour could reduce demand for the Group's products*". A greater movement of customers to PCWs and away from direct marketing channels could result in greater pricing pressure as well as a reduction in the Group's insurance market share if customers move to PCWs with whom the Group does not have arrangements or new PCWs enter the market. The growing prevalence of PCWs may reduce the number of policies written by Direct Line since the Group currently does not market that brand through PCWs in the United Kingdom. It may also lead to a reduction in the Group's ability to cross-sell products, particularly if the Group is unable to engage directly with the customer at any point during the selling process. Furthermore, growth in the use of PCWs by consumers to purchase insurance would likely lead to lower overall premium prices on such insurance, motor insurance or otherwise, which could negatively impact the Group's business.

Consumer behaviour and attitudes, technological changes, regulatory and legislative changes and actions and other factors also affect competition. Generally, the Group could lose market share, incur losses on some or all of its activities and experience lower growth if it is unable to offer competitive, attractive and innovative products and services that are also profitable, does not choose the right marketing approach, product offering or distribution strategy, fails to implement such strategies successfully or fails to anticipate, successfully adapt or adhere to such demands and changes. In particular, competitive pressures from PCWs and other new technologies and distribution channels may require changes to the Group's business operations, including IT systems and functionality, and the Group may not be able to effectively respond to these new developments in a timely and/or appropriate manner, which could have an adverse effect on the Group's business, prospects, results of operations and financial position. Any such increases in competition could result in increased pressure on product pricing, and commissions and other

acquisition costs on a number of products, which, in turn, could harm the Group's ability to maintain or increase its market share or have an adverse effect on the Group's business, prospects, results of operations and financial position.

Changes to customers' behaviour could reduce demand for the Group's products

The Group is exposed to changes in the behaviour of its customers and the markets in which it sells its insurance products. For example, changes in lifestyle, technology, regulation, or taxation could significantly alter customers' actual or perceived need for insurance and the types of insurance sought. Changes in technology could also give rise to new types of entrants into the insurance and/or insurance sales markets, for example, pay-as-you-go motor insurance, or the development of new distribution channels requiring further adaptation of the Group's business and operations. Such changes could result in reduced demand for the Group's products and require the Group to expend significant energy, resources and expenditure to change its product offering, build new risk and pricing models, modify and renew its operating and IT systems and/or retrain or hire new people. Changes to customer behaviour could also result in higher customer turnover. On average, the Group incurs fewer costs and/or makes higher profit retaining existing customers than it does acquiring new customers. This is true even for customers who replace one Group product with a comparable Group product offered under another brand. As a result, higher customer turnover could lead to higher overall costs and/or lower or eliminated profit margins due to increased pricing pressure. Such changes could have an adverse effect on the Group's business, prospects, results of operations and financial position.

The Group's claims management processes may be inefficient, leading to additional claims-related expenses and adverse inflation effects upon claims

A key assumption used in the pricing of the Group's insurance products as well as the provisions for claims is the relative time and efficiency with which claims will be notified, processed and paid. Efficient and effective claims management depends, among other things, on well-trained personnel making accurate and timely decisions with respect to claims handling. Inefficiencies and inaccuracies in managing and paying claims can lead to issues such as inaccurate indemnity decisions, inappropriate claims reserving and/or payment decisions, increased fraud and inaccurate management information for reserving and pricing, resulting in additional claims costs and claims handling related expenses as well as increased risk that technical reserves and/or pricing models will be inappropriate or inaccurate. This risk is particularly acute where the time lag between claim and payment is large. If the Group's claims management processes prove to be inefficient or ineffective or it otherwise suffers from costs or expenses above expected levels, the Group could be forced to refine its pricing models, potentially resulting in a loss of business, and increase its technical reserves. Such additional costs or inflation effects could harm the Group's profitability, which could have an overall adverse effect on the Group's business, prospects, results of operations and financial position.

The Group is exposed to fraud risks

The Group is vulnerable to internal and external fraud from a variety of sources such as employees, suppliers, intermediaries, customers and other third parties. This includes both policy (i.e. application-related) fraud and claims fraud. Although the Group employs fraud detection processes to help monitor and combat fraud, the Group is at risk from customers who misrepresent or fail to provide full disclosure of the risks covered before such cover is purchased, from policyholders who file fraudulent or exaggerated claims and from a range of other fraud related exposures, such as the fraudulent use of Group-related confidential information. These risks are higher in periods of financial stress and include payment security risks.

Additionally, the Group experiences risk from employees and staff members who fail to follow or circumvent procedures designed to prevent fraudulent activities. The occurrence or persistence of fraud in any aspect of the Group's business could damage its reputation and brands as well as its financial standing, and could have a material adverse effect on its business, prospects, results of operations and financial position.

The Group's operations support complex transactions and are highly dependent on the proper functioning of information technology and communication systems

The Group relies heavily on its operational processes and on information technology and communication systems ("**IT**") to conduct its business, including the pricing and sale of its products, measuring and

monitoring its underwriting liabilities, processing claims, assessing acceptable levels of risk exposure, setting required levels of provisions and capital and maintaining customer service and accurate records.

These processes and systems may not operate as expected, may not fulfil their intended purpose or may be damaged or interrupted by increases in usage, human error, unauthorised access, natural hazards or disasters or similarly disruptive events. Any failure of the Group's IT and communications systems and/or third-party infrastructure on which the Group relies could lead to significant costs and disruptions that could adversely affect the overall operational or financial performance of the business as well as harm the Group's reputation and/or attract increased regulatory scrutiny. In particular, whilst subject to ongoing replacement projects, certain of the Group's older systems are susceptible to inefficiencies in, among other things, selling, policy administration and claims handling.

While the Group does have in place disaster recovery and business continuity contingency plans, the occurrence of a serious disaster resulting in interruptions, delays, the loss or corruption of data or the cessation of the availability of systems, could have a material adverse impact on the Group's business, prospects, results of operations or financial position.

In preparation for the Group's divestment from the RBS Group, the Group implemented some new IT systems and processes in order to prepare to operate on a stand-alone basis, including new arrangements with third-party suppliers. These key new IT initiatives were significant, both in terms of scale and cost but were implemented with minimal business impact.

Furthermore, the Group will be making a significant investment in its own IT to prepare for and execute the migration of the IT services that will be provided to the Group by the RBS Group under a transitional services agreement (the "**TSA**") (see Part XVI: "*Additional Information—Material Contracts—Transitional Services Agreement*") and expects to incur one-off costs in the region of £100 million, before applicable tax deductions, in roughly similar amounts over 2013 and 2014. This amount does not include operating costs to be incurred under the transitional services agreement with the RBS Group or other capital expenditure in relation to IT in the ordinary course of the Board's investment plans for the Group. See "*—The Group relies on a transitional service agreement with the RBS Group, particularly with respect to IT services*". The IT initiatives may not deliver what is required on time or the IT migration may not be possible within the expected cost of £100 million, or may not provide the system functionality or performance levels required to support the current and future needs of the Group's business. The IT systems and services provided to the Group under the TSA will need to be replaced on or before the date of the expiry of the initial term of the TSA, being 36 months after Admission or until migration has completed. The terms on which the Group purchases these new IT systems and services, or the functionality of the systems themselves, may be inferior to those of the systems previously provided by the RBS Group or those available elsewhere in the market and, in relation to third-party suppliers, may be on terms that are less favourable than the terms on which services were previously provided by third parties to the RBS Group, and from which the Group has historically benefitted and will continue to benefit during the period of the transitional services agreement. See also "*—The Group may fail to execute its ongoing strategic transformation plan and/or the expected benefits of that plan may not be achieved at the time or to the extent expected, or at all*".

The Group relies on a transitional service agreement with the RBS Group, particularly with respect to IT services

In connection with the Company's divestment from the RBS Group, the Company has entered into the TSA with the RBS Group for the continued provision of certain services to the Company for a specified period (see Part XVI "*Additional Information—Material Contracts—Transitional Services Agreement*"). Services provided for under the TSA include, without limitation, certain IT, business continuity, property, and web services. In particular, the Group will rely on the RBS Group to provide IT hosting, support and maintenance services that are critical to maintaining the level of support for the ongoing needs of the business (including in relation to its partners). The systems supporting the Group's customer-facing operations are and always have been largely separate from the RBS Group systems, although run on shared infrastructure. Whilst the majority of the systems run under the TSA are independent of the RBS Group's other systems, any technical problems occurring within the RBS Group could have an adverse effect on the Group. IT issues experienced by certain companies within the RBS Group in June 2012 caused no material disruption to the Group's operations. The TSA also provides for the RBS Group to assist with the migration of the Group's systems where they are owned by the Group and operated by the RBS Group, and data from the RBS Group infrastructure to that of the Group or third parties at or prior to the end of the TSA period. As with all of the Group's IT systems, interruptions to or problems with the Group's IT systems and services provided under the TSA or as a result of migration from the RBS Group infrastructure could cause material damage to the Group's business and reputation, and could cause the

Group to incur higher administrative and other costs both for the processing of business and the potential remediation of disputes. If the RBS Group fails to provide or procure the services envisaged or provide them in a timely manner, under the TSA or as part of the migration of such services under the TSA, such failure could have a material adverse effect on the Group's business, prospects, results of operations and financial position.

The Group is dependent on the use of third-party IT, software, data and service providers

Certain of the Group's IT and operational support functions are outsourced to third parties but remain critical to the Group's business, such as mitigation of electronic attacks. Some of these functions are sourced by the Group directly while others are or will be provided to the Group indirectly through relationships between third parties and the RBS Group under the TSA. In addition, the Group is dependent on the use of certain third-party software and data in order to conduct its business, including in pricing of products and reserving claims. Further, the outsourcing to third parties has involved the relocation of some of the Group's back office operations to third-party providers based in India, and may include additional relocation of operations (both front and back office) to areas outside the United Kingdom in the future. The Group is reliant in part on the continued performance, accuracy, compliance and security of all these service providers. If the contractual arrangements with any third-party providers are terminated, the Group may not find an alternative outsource provider or supplier for the services, on a timely basis, on equivalent terms or without significant expense or at all.

In addition, the information and processes the Group uses may be protected by patents, copyrights in software or other materials, rights in databases, rights of confidence or other intellectual property rights owned by third parties. The Group seeks to obtain such licences or consents in respect of any intellectual property rights owned by third parties that it may identify as necessary to its business. However, claims that its activities infringe such third-party intellectual property rights could adversely affect the Group's business. Third-party providers have also mishandled the Group's customer data on certain occasions, resulting in the Group having to make notifications of such incidents to the relevant regulators. Any reduction in third-party product quality or any failure by a third party to comply with the Group's licensing or regulatory requirements, including requirements with respect to the handling of customer data, could cause a material disruption to or adverse financial and/or reputational impact on the Group's business. Any of these events could have a material adverse effect on the Group's business, prospects, results of operations and financial position.

Failure to maintain adequately and protect customer and employee information could have a material adverse effect on the Group

The Group collects and processes personal data (including name, address, age, bank and credit card details and other personal data) from its customers, third-party claimants, business contacts and employees as part of the operation of its business, and therefore it must comply with data protection and privacy laws and industry standards in the United Kingdom, Germany and Italy. Those laws and standards impose certain requirements on the Group in respect of the collection, use, processing and storage of such personal information. For example, under UK and EU data protection laws and regulations, when collecting personal data, certain information must be provided to the individual whose data is being collected. This information includes the identity of the data controller, the purpose for which the data is being collected and any other relevant information relating to the processing. There is a risk that data collected by the Group and its appointed third parties is not processed in accordance with notifications made to, or obligations imposed by, data subjects, regulators, or other counterparties or applicable law. There is a further risk that recent European Community proposals on data protection will impose a disproportionate burden on insurers and impact the ability of insurers to share information to prevent fraud and other financial crime. Failure to operate effective data collection controls could potentially lead to regulatory censure, fines, reputational and financial costs as well as result in potential inaccurate rating of risks or overpayment of claims.

The Group is also subject to certain data protection industry standards, and may be contractually required to comply with those standards. For example, as a major processor of payments from payment cards, the Group is required to comply with the Payment Card Industry Data Security Standard ("**PCI DSS**") as part of its contractual obligations to merchant acquirers. While the Group is currently upgrading certain systems with respect to PCI DSS, it is not currently in full compliance with those standards, which could have a negative financial impact on the Group. For example, there is a risk that certain types of data

security breaches could subject the Group to liability, contractual penalties and/or damage to the Group's brands and reputation.

In addition, the Group is exposed to the risk that the personal data it controls could be wrongfully accessed and/or used, whether by employees or other third parties, or otherwise lost or disclosed or processed in breach of data protection regulations. If the Group or any of the third-party service providers on which it relies (including the RBS Group under the TSA) fail to process, store or protect such personal data in a secure manner or if any such theft or loss of personal data were otherwise to occur, the Group could face liability under data protection laws. This could also result in damage to the Group's brands and reputation as well as the loss of new or repeat business, any of which could have a material adverse effect on the Group's business, prospects, results of operations and financial position.

The Group faces a number of one-off or restructuring costs in connection with its separation from the RBS Group and new cost saving initiatives

As part of its separation from the RBS Group, the Group has incurred significant restructuring costs as it has established its own stand-alone arrangements in a wide range of areas including human resources and payroll, head office, governance, and control functions, where it previously relied on support and services from the RBS Group, the majority of which are not provided under the TSA. While these services and functions are relatively new to the Group, they have been subject to pilot testing and are now fully implemented into the ordinary operational and reporting processes of the Group. However, as with any business, there remains a risk that the Group could suffer operational difficulties in due course, which, either directly or as a result of the need for further investment in these new services and functions, could have a material adverse effect on the Group's overall business, prospects, results of operations and financial position.

The Group incurred significant restructuring costs and other one-off costs of £54.0 million in the financial year ended 31 December 2011 and £108.7 million in the six months ended 30 June 2012. The Group will incur additional one-off restructuring and separation costs, including the one-off costs to be incurred in connection with its planned cost savings initiatives (see Part XII: "*Operating and Financial Review—Key factors affecting results of operations—Cost and operational efficiency*"). These costs are significant, and the Group currently estimates restructuring and other one-off costs from separation and administrative cost reduction initiatives for the year ending 31 December 2012 will amount to a total of approximately £180 million, of which the Board expects in the region of £70 million will be incurred in the second half of 2012 (comprising £60 million principally for separation and divestment costs and one-off costs of £10 million relating to planned cost reduction initiatives). Further one-off restructuring costs of £90 million are expected in 2013 in respect of the planned cost reduction initiatives. However, the actual costs could be higher and the period over which they are incurred could be longer. These are in addition to the expected £100 million costs for migration of the Group's IT services from the RBS Group (as identified under the heading "*—The Group's operations support complex transactions and are highly dependent on the proper functioning of information technology and communication systems*"). All of the above cost estimates are stated before any applicable tax deductions.

The Group could be adversely affected by the loss of one or more key employees, or by an inability to attract and retain, or obtain FSA approval for, qualified personnel

The Group depends on the continued contributions of its senior management and other key employees, a number of whom have only recently joined the Group. The loss of services of one or more of the Group's key employees could adversely affect its business. In addition, the Group may need to temporarily fill certain key roles with interim employees while recruitment of permanent staff remains ongoing. The Group's continued success also depends on its ability to attract, motivate and retain highly competent specialists, particularly those with financial, IT, underwriting, actuarial, Solvency II and other specialist skills. Competition for senior managers as well as personnel with these skills and proven ability is intense among insurance companies. The Group competes with other financial services groups for skilled personnel, primarily on the basis of its reputation, financial position, remuneration policies and support services, and may incur significant costs to recruit and retain appropriately qualified individuals.

In addition, the FSA also has the power to regulate individuals in the insurance business who deal with customers, such as providing advice to customers on the Group's insurance products, and individuals with significant influence over the key functions of an insurance business, such as governance, finance, audit and management functions. The FSA may not approve individuals for such functions unless it is satisfied that they have appropriate qualifications and/or experience and are fit and proper to perform those

functions, and may withdraw its approval for individuals whom it deems no longer fit and proper to perform those functions.

In addition, the Group's employees are represented through collective bargaining agreements in Italy and by a works council in Germany and there is a risk that economic uncertainties, particularly with respect to austerity measures in Italy, could lead to possible disputes with those employees.

The Group's inability to attract and retain, or obtain FSA approval for, directors and highly skilled personnel, and to retain, motivate and train its staff effectively could adversely affect its competitive position, which could in turn result in an adverse effect to its business, prospects, results of operations and financial position.

The Group relies on intermediaries to market and distribute insurance, particularly within its commercial business

The Group relies on intermediaries for the marketing and distribution of a majority of its commercial products and services. The Group's intermediaries are independent of the Group. In most cases, the Group does not have exclusivity agreements in place with its intermediaries, and as a result they are free to offer products from other insurance companies as well, with no obligation to give priority to the products of the Group. The successful distribution of the Group's commercial products therefore depends on the preferences of intermediaries for the Group's products and services, and the Group competes with other insurers and financial institutions to attract and retain commercial relationships with intermediaries. In addition, some of the Group's commercial business brokers have the ability to make underwriting or claims handling decisions that could affect the Group, and may sell insurance or pay claims under circumstances otherwise outside the underwriting or claims handling policies set by the Group. Failure to maintain relationships with intermediaries or underwriting or claims handling decisions made by intermediaries in contravention of Group policies could result in a loss of market share for the Group's commercial products or a reduction in the sale or profitability of its products, which could, in turn, have an adverse effect on its business, prospects, results of operations and financial position.

The Group may make acquisitions or disposals in the future

Apart from an alternative business structure currently being considered by the Group that if implemented would allow it to begin offering legal services (see Part IX: "*Regulatory Overview—Regulatory developments—Alternative business structures*") the Group is not expecting to make any acquisitions or disposals in the reasonably foreseeable future, though it has in the past and may in the future make acquisitions and disposals of businesses that are consistent with its core strategic priorities. In any future acquisition, the Group will endeavour to conduct appropriate due diligence, which will include, amongst other matters and as appropriate, assessment of the adequacy of claims reserves, assessment of the recoverability of reinsurance and other balances, enquiries with regard to outstanding litigation and consideration of local regulatory and taxation matters where appropriate. Consideration will also be given to potential costs, risks and issues in relation to the integration of any proposed acquisitions with existing Group operations. However, there can be no assurance that the due diligence undertaken will be accurate or complete, and such due diligence may not identify or mitigate all material risks to which the entity being acquired is exposed. In addition, the integration of any proposed acquisition may not be successful or in line with the Group's expectations. The Group will seek, where appropriate, contractual representations and warranties in connection with any acquisition and, where necessary, additional indemnifications in relation to specific risks. However, there can be no guarantee that such protection will be obtained or be adequate in all circumstances. The Group may also provide relevant representations, warranties and indemnities to counterparties on any disposal. While most such clauses are likely to be customary in such contracts, they may result in the Group receiving claims from counterparties. Even if the Group identifies an attractive opportunity, it may not be able to complete successfully the acquisition or disposal based on limited financial resources or onerous regulatory requirements. Failure to adequately protect the Group from losses resulting from acquisitions or disposals, including losses resulting from the unsuccessful integration of future acquisitions, could damage the Group's reputation and brands, and could have an adverse effect on the Group's business, prospects, results of operations and financial position.

Changes in taxation laws may negatively impact the Group and/or the decisions of customers

Changes in corporate and other tax rules could have both a prospective and retrospective impact on the Group's business, prospects, results of operations or financial position. In general, changes to, or in the interpretation of, existing tax laws, or amendments to existing tax rates (corporate or personal), or the introduction of new tax legislation may adversely affect the business, prospects, results of operations and

financial position of the Group, either directly or indirectly or as a result of changes in the insurance purchasing decisions of customers. Changes to legislation that specifically governs the taxation of insurance companies might adversely affect the Group's business. While changes in taxation laws would affect the insurance sector as a whole, changes may be more detrimental to particular operators in the industry. The relative impact on the Group will depend on the areas impacted by the changes, the mix of business within the Group's portfolio and other relevant circumstances at the time of the change.

U.S. Foreign Account Tax Compliance Withholding

Sections 1471 through 1474 of the U.S. Internal Revenue Code ("**FATCA**") impose a new reporting regime and potentially a 30% withholding tax with respect to certain payments to any non-U.S. financial institution (a foreign financial institution, or "**FFI**" (as defined by FATCA)) that (i) does not become a "**Participating FFI**" by entering into an agreement with the U.S. Internal Revenue Service ("**IRS**") to provide certain information on its account holders or (ii) is not otherwise exempt from or in deemed-compliance with FATCA. The new withholding regime will be phased in beginning in 2014 for payments received from sources within the United States and will apply to "**foreign passthru payments**" (a term not yet defined) no earlier than 2017.

After consultation with a number of potential partner countries, the United States has recently released a model intergovernmental agreement ("**model IGA**") to facilitate the implementation of FATCA. Pursuant to FATCA and the model IGA, an FFI in a signatory country could be treated as a deemed-compliant FFI, an exempt FFI or a "**Reporting FFI**" not subject to FATCA withholding on any payments it receives and, with respect to payments it makes from sources within the United States, would not be required to withhold. It is not yet certain whether a Reporting FFI would be required to withhold on foreign passthru payments. A Reporting FFI would, however, be required to report certain information on its account holders to its home government. On 12 September 2012, the United States and the United Kingdom entered into an agreement (the "**US-UK IGA**") based largely on the model IGA.

The Company expects to be treated as an FFI, and pursuant to the US-UK IGA, expects to be treated as a Reporting FFI and does not expect to be subject to FATCA withholding. There can be no assurance, however, that the Company will be treated as a Reporting FFI and that such withholding will not be imposed against the Company or other FFIs within the Group. If the Company and other FFIs in the Group do not become Participating FFIs, Reporting FFIs, or are not treated as exempt from or in deemed-compliance with FATCA, the Company and other FFIs in the Group may be subject to a 30% withholding tax on all, or a portion of all, payments received from U.S. sources, Participating FFIs, and, potentially, Reporting FFIs. Any such withholding imposed on the Company or other FFIs in the Group may have a material adverse effect on the Group's business, prospects, results of operations and financial position.

If the Company becomes a Participating FFI under FATCA or is a Reporting FFI pursuant to the US-UK IGA, the Company and other financial institutions through which payments on the Ordinary Shares are made may be required to withhold U.S. tax at a rate of 30% on all, or a portion of, payments if any FFI through or to which payment on such Ordinary Shares is made, is not a Participating FFI, a Reporting FFI, or otherwise exempt from or in deemed-compliance with FATCA. If an amount in respect of FATCA withholding were to be deducted or withheld, neither the Company nor any other person will pay additional amounts as a result of the deduction or withholding of such tax.

FATCA is particularly complex and its application is uncertain at this time. The above description is based in part on proposed regulations, official guidance and the model IGA, all of which are subject to change or may be implemented in a materially different form. Prospective investors should consult their own tax advisers on how these rules may apply to the Company and to payments they may receive in connection with the Ordinary Shares.

Changes to IFRS generally or specifically for insurance companies may adversely affect the Group's financial results

Changes to IFRS for insurance companies have been proposed in recent years and further changes may be proposed in the future. The International Accounting Standards Board has published proposals in its IFRS 4 Insurance Contracts Phase II for Insurers Exposure Draft ("**Phase II**") that would introduce significant changes to the statutory reporting of insurance entities that prepare financial statements according to IFRS. The accounting proposals, which are not expected to become effective before 2015, will change the presentation and measurement of insurance contracts, including the effect of technical reserves and reinsurance on the value of insurance contracts. It is uncertain whether and how the proposals in the

exposure draft will affect the Group should they become definitive international financial reporting standards. Current proposals under Phase II may have an adverse effect on the manner in which the Group reports provisions and therefore identifies and reports revenues and costs. These and any other changes to IFRS that may be proposed in the future, whether or not specifically targeted at insurance companies, could adversely affect the Group's results of operations and financial position.

RISKS RELATED TO THE RBS GROUP'S SHAREHOLDING IN THE COMPANY

As a condition to receiving aid given to it by HM Treasury, the RBS Group is required to divest a controlling interest in the Company by 31 December 2013, and divest any remaining interest by 31 December 2014. There are risks that might impact the Company and the Group as long as the Selling Shareholder remains a significant shareholder in the Company. Highlighted below are certain of the key risks that apply to the RBS Group and which, should they arise, may have a material adverse impact on the Group's business, prospects, results of operations and financial position.

The RBS Group will continue to exert substantial influence over the Group

Immediately following Admission, the Selling Shareholder will continue to own between approximately 75.0% and 66.7% (assuming no exercise of the Over-allotment Option, and between approximately 71.3% and 61.7% if the Over-allotment Option is exercised in full) of the issued ordinary share capital of the Company. While it remains a significant shareholder of the Group, the Selling Shareholder will continue to have the power, among other things, to affect or influence the Group's legal and capital structure, as well as the ability to elect and change its directors, management and to approve other changes to its operations. The interests of the RBS Group, including its obligation to divest a controlling interest in the Company by 31 December 2013, and divest any remaining interest by 31 December 2014 (see also "*—The Selling Shareholder has a legal obligation to divest its controlling interest in the Group by the end of 2013 and completely divest by the end of 2014 and the manner and exact timing of any divestment is uncertain*"), could conflict with those of the Group, and this concentration of ownership may also have the effect of delaying, deferring or preventing the Group's ability to effect certain types of transactions that require approval by the Selling Shareholder, including by special resolution. The Company has entered into a Relationship Agreement which will regulate (in part) the degree of control that the Selling Shareholder and its subsidiaries may exercise over the management of the Company but which grants the Selling Shareholder the right to appoint up to two members to the Board depending on the size of its holding of Ordinary Shares (see Part XVI: "*Additional Information—Material Contracts—Relationship Agreement*"). In addition, Standard & Poor's and Moody's currently link the financial strength ratings of U K Insurance to the overall rating of the RBS Group. As a consequence, Standard & Poor's has indicated that its rating for U K Insurance could be affected by future rating actions on the RBS Group by Standard & Poor's, while Moody's has indicated that its rating for U K Insurance could be negatively impacted by a material weakening of the RBS Group's credit profile as reflected in any further downgrade in the RBS Group's ratings or any delay to the divestment of the Company from the RBS Group.

The RBS Group may face the risk of full nationalisation or other resolution procedures under the Banking Act 2009

Under the Banking Act 2009 (the "**Banking Act**"), substantial powers have been granted to HM Treasury, the Bank of England and the FSA (together, the "**Authorities**") as part of a special resolution regime (the "**SRR**"). These powers enable the Authorities to regulate UK banks, building societies and other institutions with permission to accept deposits pursuant to Part IV of the FSMA (each a "**relevant entity**") where certain conditions are met. The SRR consists of three stabilisation options and two insolvency and administration procedures applicable to the relevant entities, which may be commenced by the Authorities. The stabilisation options provide for: (i) transfer of all or part of the business of the relevant entity to a private sector purchaser; (ii) transfer of all or part of the business of the relevant entity to a "bridge bank" established by the Bank of England; and (iii) temporary public ownership (nationalisation) of the relevant entity or its UK-incorporated holding company. In each case, the Authorities have been granted wide powers under the Banking Act including powers to modify contractual arrangements in certain circumstances and powers for HM Treasury to disapply or modify laws (with possible retrospective effect) to enable the powers under the Banking Act to be used effectively. Nationalisation or other forms of resolution of the RBS Group could result in action being taken in relation to the Selling Shareholder's ongoing holding of Ordinary Shares (particularly if nationalisation or other forms of resolution were considered to be a change of control in the Group) which is adverse to the interests of the Group, including, for example, a change of control in the Group and could result in material changes to the Group's business and/or impact the RBS Group's plans for full divestment of the Group. See also

"*—Contractual arrangements within the Group and between the RBS Group and the Group may be created, modified or cancelled depending on events that occur within the RBS Group*".

Contractual arrangements within the Group and between the RBS Group and the Group may be created, modified or cancelled depending on events that occur within the RBS Group

If the RBS Group or certain members thereof were taken into temporary public ownership and a partial transfer of its or any relevant entity's business were effected, the transfer may directly affect the Group by creating, modifying or cancelling the Group's contractual arrangements with a view to ensuring the provision of such services and facilities as are required to enable the effective operation of the transferred business (or any part of it). For example, the transfer may (among other things) (i) require the Group to support and co-operate with the transferor; (ii) cancel or modify contracts or arrangements between the transferred business and a Group company (which may include the TSA and the Group's distribution arrangements with RBS/NatWest); or (iii) impose additional obligations on the Group under new or existing contracts. There can be no assurance that the taking of any such actions would not adversely affect the ability of the Group to effectively conduct its business or satisfy its obligations under any issued securities or related contracts.

The RBS Group is subject to a variety of risks as a result of implementing the State Aid restructuring plan which could adversely affect the Group

The Selling Shareholder was required to obtain approval for the aid given to it by HM Treasury in December 2008 (the "**State Aid**"). As part of the State Aid approval, the RBS Group, together with HM Treasury, agreed the terms of a restructuring plan (the "**State Aid restructuring plan**"). The RBS Group is subject to a variety of risks as a result of implementing the State Aid restructuring plan, including required asset disposals. In particular, the RBS Group agreed to undertake a series of measures to be implemented over a four-year period from December 2009, which include disposing of the Group (subject to potentially maintaining a non-controlling interest until the end of 2014). If after Admission, the RBS Group fails to complete the required disposal of the Group, under the terms of the State Aid approval, a divestiture trustee may be empowered to conduct the disposal, with the mandate to complete the disposal of the RBS Group's residual interest in the Ordinary Shares at no minimum price, which could have a material and adverse impact on the liquidity and trading price of the Ordinary Shares.

In implementing certain aspects of the State Aid restructuring plan, the RBS Group will lose existing customers and as a result the Group will lose the potential for realising associated revenues through the sale of insurance products to those customers under the Group's distribution arrangements with RBS/NatWest.

The Selling Shareholder has a legal obligation to divest its controlling interest in the Group by the end of 2013 and completely divest by the end of 2014 and the manner and exact timing of any divestment is uncertain

As a condition to receiving State Aid, the Selling Shareholder is required by the end of 2014 to divest its insurance business, being the Group. See also "*—The RBS Group is subject to a variety of risks as a result of implementing the State Aid restructuring plan which could adversely affect the Group*". The Selling Shareholder's current intention for disposal of its interest in the Group is by way of the Offer and then, subject to (i) market conditions and (ii) the terms of the lock-up provisions that prevent the Selling Shareholder from disposing of any Ordinary Shares, without the prior written consent of the Joint Global Coordinators, for a period of 180 days from Admission, the sale of the Ordinary Shares held by the Selling Shareholder following Admission (the "**Residual Shares**") in a number of tranches.

However, there remains considerable uncertainty over the timing and manner of the divestment of the Residual Shares and the Company has no control over the manner in which the Selling Shareholder may seek to divest its Residual Shares. The Company appreciates that the Selling Shareholder will need to continue to assess all available options, and as such, the divestment could be achieved in a number of different ways including, without limitation (i) by the sale of the Residual Shares in a number of tranches (as described above); (ii) by the sale of all the Residual Shares in a single tranche; or (iii) by the sale of a significant tranche of the Residual Shares representing in excess of 30% of the issued share capital of the Company. Sales under paragraphs (ii) and (iii) could be made to a single third-party purchaser which might be another insurance company or financial sponsor or another owner. Any sale under (ii) or (iii) would, absent the consent of the UK Takeover Panel, require such a purchaser to make an offer to acquire all the Ordinary Shares not held by it at the price at which the Residual Shares are sold by the Selling Shareholder, subject to and in accordance with the UK Takeover Code, and there can be no guarantee that

the price at which RBS is willing to sell its Residual Shares will be at a level that the Board is prepared to recommend to Shareholders.

Should the divestment of the Residual Shares occur by way of a single or significant tranche sale to a third party result in a purchaser being required to make an offer as described above, while holders of Ordinary Shares may not be obliged to accept any tender offer made (unless (i) the compulsory acquisition provisions of the Companies Act apply (see Part XVI: "*Additional Information—Mandatory bids and compulsory acquisition*"), or (ii) if any such offer were to be implemented by way of a scheme of arrangement, which would bind all holders of Ordinary Shares if Shareholders holding 75% in value and being 50% in number vote in favour of such scheme), this could subsequently result in a significant change to the strategy, management and risk profile of the Group including, subject to regulatory restrictions, the Group's capital management policy, financial leverage, investment and/or reinsurance strategy or dividend policy and, depending on the level of ownership secured by the purchaser, could result in the delisting of the Ordinary Shares from the Official List and the London Stock Exchange's main market for listed securities.

In addition, a change of control of the Group could result in key contracts being terminated by the counterparties to such contracts, which could give rise to material disruptions to the Group's business, additional costs to renegotiate those contracts, difficulties in managing its operations, and adverse impacts to its customers. As a result of these effects, the eventual change in ownership could have a material adverse effect on the Group's business, results of operations and financial position.

RISKS RELATING TO THE OFFER

The value of the Ordinary Shares may be affected by future sales by the Selling Shareholder

The Selling Shareholder is required to cede control of the Company by the end of 2013 and divest of any remaining interest by the end of 2014. As a result, subject to the lock-up provisions that prevent the Selling Shareholder from disposing of any Ordinary Shares, without the prior written consent of the Joint Global Coordinators, for a period of 180 days from Admission, there are likely to be substantial sales of the Ordinary Shares the Selling Shareholder holds in the Company in 2013 and 2014, which could have a negative effect on the market price of the Ordinary Shares. The Company has no control over the timing or nature of such sales, and how much of the Selling Shareholder's interest may be sold at any given time or in a given period. See also "*—Risks relating to the RBS Group's shareholding in the Company—The Selling Shareholder has a legal obligation to divest its controlling interest in the Group by the end of 2013 and completely divest by the end of 2014 and the manner and exact timing of any divestment is uncertain*".

There has been no prior public trading market for the Ordinary Shares

Prior to the Offer, there has been no public trading market for the Ordinary Shares. The Offer Price will be determined by the Selling Shareholder in consultation with the Joint Bookrunners and the Company and may not be indicative of the market price for the Ordinary Shares following Admission. Although the Company intends to apply to the FSA for admission of the Ordinary Shares to listing on the Official List and intends to apply to the London Stock Exchange for admission of the Ordinary Shares to trading on its market for listed securities, the Group can give no assurance that an active trading market for the Ordinary Shares will develop or, if developed, can be sustained following the closing of the Offer. If an active trading market is not developed or maintained, the liquidity and trading price of the Ordinary Shares could be materially and adversely affected.

The value of the Ordinary Shares may fluctuate significantly

Following the Offer, the value of the Ordinary Shares may fluctuate significantly as a result of a large number of factors, including, but not limited to, those referred to in this Part II: Risk Factors, as well as period-to-period variations in operating results or change in revenue or profit estimates by the Group, industry participants or financial analysts. The value of the Ordinary Shares could also be affected by developments unrelated to the Group's operating performance, such as the operating and share price performance of other companies that investors may consider comparable to the Group, speculation about the Group in the press or the investment community, strategic actions by competitors, including acquisitions and/or restructurings, changes in market conditions and regulatory changes in any number of countries, whether or not the Group derives significant revenue therefrom.

The market price of the Ordinary Shares could be negatively affected by sales of substantial amounts of such Ordinary Shares in the public markets, including following the expiry of the lock-up period, or the perception that these sales could occur.

Following completion of the Offer, the Selling Shareholder will own, between approximately 75.0% and 66.7% of the Company's issued ordinary share capital (between approximately 71.3% and 61.7%, assuming the Over-allotment Option is exercised in full).

Pursuant to the Underwriting Agreement, the Company, the Selling Shareholder and each of the Directors and Senior Managers has agreed that, subject to certain exceptions, during the period of 180 days (in the case of the Company and the Selling Shareholder) and 360 days (in the case of the Directors) from the date of Admission, it/they will not, without the prior written consent of the Joint Global Coordinators offer, sell or contract to sell, or otherwise dispose of any Ordinary Shares (or any interest therein in respect thereof) or enter into any transaction with the same economic effect as any of the foregoing.

Sales of a substantial number of Ordinary Shares by the Company, the Directors or, despite the known requirement to divest described above, the Selling Shareholder, in the public market after these restrictions expire, or the knowledge that they will, or perception that these sales may occur, could depress the market price of the Ordinary Shares and could impair the Group's ability to raise capital through the sale of additional equity securities.

Further details of these arrangements, which are contained in the Underwriting Agreement, are set out in Part XVI: "*Additional Information—Material Contracts*".

Shareholders may earn a negative or no return on their investment in the Group

The Company's results of operations and financial condition are entirely dependent on the trading performance of the members of the Group. While the Directors intend to adopt a progressive dividend policy that maintains an appropriate level of dividend cover (see Part XII: "*Information on the Company and the Group—Dividend Policy*"), there can be no assurance that the Company will pay dividends in the future. Any decision to declare and pay dividends in the future will be made at the discretion of the Board and will depend on, among other things, applicable law, regulation, restrictions, the Company's financial position, regulatory capital requirements, working capital requirements, finance costs, general economic conditions and other factors the Directors deem significant from time to time. The Company's ability to pay dividends will also depend on the level of distributions, if any, received from its operating subsidiaries.

The issue of additional shares in the Company in connection with future acquisitions, any share incentive or share option plan or otherwise may dilute all other shareholdings

The Group may seek to raise financing to fund future acquisitions and other growth opportunities. The Group may, for these and other purposes, such as in connection with share incentive and share option plans, issue additional equity or convertible equity securities. As a result, the Company's existing shareholders would suffer dilution in their percentage ownership.

Shareholders outside the United Kingdom may not be able to participate in future equity offerings

The Articles of the Company provide for pre-emptive rights to be granted to shareholders in the Company, unless such rights are disapplied by a shareholder resolution. However, securities laws of certain jurisdictions may restrict the Group's ability to allow participation by Shareholders in future offerings. In particular, Shareholders in the United States may not be entitled to exercise these rights unless either the rights and Ordinary Shares are registered under the Securities Act, or the rights and Ordinary Shares are offered pursuant to an exemption from, or transaction not subject to, the registration requirements of the Securities Act.

Directors	
Michael Nicholas Biggs	*(Chairman)*
Paul Robert Geddes	*(Chief Executive Officer)*
Anthony Jonathan Reizenstein	*(Chief Financial Officer)*
Glyn Parry Jones	*(Senior Independent Non-Executive Director)*
Andrew William Palmer	*(Independent Non-Executive Director)*
Jane Carolyn Hanson	*(Independent Non-Executive Director)*
Clare Eleanor Thompson	*(Independent Non-Executive Director)*
Priscilla Audrey Vacassin	*(Independent Non-Executive Director)*
Bruce Winfield Van Saun	*(Non-Executive Director)*
Mark Catton	*(Non-Executive Director)*
Company Secretary	Humphrey Michael Tomlinson
Registered and Head Office of the Company	Churchill Court Westmoreland Road Bromley BR1 1DP United Kingdom
Advisers	
Joint Sponsors	Goldman Sachs International Peterborough Court 133 Fleet Street London EC4A 2BB United Kingdom
	Morgan Stanley & Co. International plc 25 Cabot Square London E14 4QA United Kingdom
Joint Global Coordinators	Goldman Sachs International Peterborough Court 133 Fleet Street London EC4A 2BB United Kingdom
	Morgan Stanley Securities Limited 25 Cabot Square London E14 4QA United Kingdom
Joint Bookrunners	Goldman Sachs International Peterborough Court 133 Fleet Street London EC4A 2BB United Kingdom
	Morgan Stanley Securities Limited 25 Cabot Square London E14 4QA United Kingdom
	UBS Limited 1 Finsbury Avenue London EC2M 2PP United Kingdom

Joint Lead Managers	Citigroup Global Markets Limited 33 Canada Square London E14 5LB United Kingdom
	HSBC Bank plc 8 Canada Square London E14 5HQ United Kingdom
	Merrill Lynch International 2 King Edward Street London EC1A 1HQ United Kingdom
Co-Managers	BNP PARIBAS 16 Boulevard Des Italiens 75009 Paris France
	Commerzbank Aktiengesellschaft 30 Gresham Street London EC2V 7PG United Kingdom
	Investec Bank plc 2 Gresham Street London EC2V 7QP United Kingdom
	Keefe, Bruyette & Woods Limited 6-8 Underwood Street London N1 7JQ United Kingdom
	RBC Europe Limited Riverbank House 2 Swan Lane London EC4R 3BF United Kingdom
Intermediaries Offer Underwriter and Coordinator	Barclays Bank PLC 5 The North Colonnade Canary Wharf London E14 4BB United Kingdom
English and US legal advisers to the Company	Allen & Overy LLP One Bishops Square London E1 6AD United Kingdom
English and US legal advisers to the Joint Sponsors, Joint Global Coordinators, Joint Bookrunners, Joint Lead Managers and Co-Managers and the Intermediaries Offer Underwriter and Coordinator	Linklaters LLP One Silk Street London EC2Y 8HQ United Kingdom

Auditors and Reporting Accountants	Deloitte LLP 2 New Street Square London EC4A 3BZ United Kingdom
Reporting Actuary	Towers Watson Limited Saddlers Court 64-74 East Street Epsom Surrey KT17 1HB United Kingdom
Registrar	Computershare Investor Services PLC The Pavilions Bridgwater Road Bristol BS99 6ZY United Kingdom

PART IV—EXPECTED TIMETABLE OF PRINCIPAL EVENTS AND OFFER STATISTICS

EXPECTED TIMETABLE OF PRINCIPAL EVENTS

Latest time and date for receipt of completed application form by the Intermediaries in respect of the Intermediaries Offer[1]	5.00 p.m. on 9 October 2012
Latest time and date for receipt of indications of interest from institutional investors under the Institutional Offer	5.00 p.m. on 10 October 2012
Publication of the Pricing Statement containing the Offer Price	11 October 2012
Announcement of the results of the Offer through a Regulatory Information Service announcement and notification of allocations	7.00 a.m. on 11 October 2012
Commencement of conditional dealings on the London Stock Exchange	8.00 a.m. on 11 October 2012
Admission and commencement of unconditional dealings on the London Stock Exchange	8.00 a.m. on 16 October 2012
CREST accounts credited	by 16 October 2012
Despatch of definitive share certificates (where applicable)	from 23 October 2012

(1) This date is indicative only and may, in the discretion of the Joint Global Coordinators (with the agreement of the Company and the Selling Shareholder), be subject to change.

Each of the times and dates in the above timetable is subject to change. References to times are to London time unless otherwise stated. Temporary documents of title will not be issued.

It should be noted that, if Admission does not occur, all conditional dealings will be of no effect and any such dealings will be at the sole risk of the parties concerned.

OFFER STATISTICS

Price Range (per Ordinary Share)[1]	between 160p and 195p
Number of Ordinary Shares in issue	1,500,000,000
Number of Ordinary Shares in the Offer to be sold by the Selling Shareholder[2]	up to 500,000,000
Percentage of the Company's issued share capital being offered in the Offer[2]	up to 33.3%
Maximum number of Ordinary Shares subject to the Over-allotment Option to be sold by the Selling Shareholder	75,000,000
Estimated gross proceeds of the Offer receivable by the Selling Shareholder[3]	£776.6 million
Estimated net proceeds of the Offer receivable by the Selling Shareholder[3][4]	£755.3 million
Expected market capitalisation of the Company at the Offer Price[5]	£2,662.5 million

Notes:

(1) The Offer Price may be set within, above or below, the Price Range. To the fullest extent permitted by law, applications received under the Institutional Offer and the Intermediaries Offer are irrevocable and are based on the amount the applicant wishes to invest and not the number of Ordinary Shares or the Offer Price. It is expected that the Pricing Statement containing the Offer Price and the number of Ordinary Shares which are the subject of the Offer will be published on or about 11 October 2012. Further details of the Offer are contained in Part VI: "*Details of the Offer*".

(2) Assumes the Over-allotment Option is not exercised.

(3) Assumes that the number of Offer Shares sold is the mid-point between 25.0% and 33.3% of the total number of issued Ordinary Shares, no exercise of the Over-allotment Option and that the Offer Price is set at the mid-point of the Price Range.

(4) After deduction of commissions and expenses, VAT and stamp duty payable by the Selling Shareholder of £21.2 million.

(5) Assumes the Offer Price is set at the mid-point of the Price Range.

PART V—PRESENTATION OF INFORMATION

General

Investors should rely only on the information in this Prospectus. No person has been authorised to give any information or to make any representations in connection with the Offer other than those contained in this Prospectus and, if given or made, such information or representations must not be relied upon as having been authorised by or on behalf of the Company, the Directors, the Selling Shareholder or the Banks. No representation or warranty, express or implied, is made by any of the Banks or any selling agent as to the accuracy or completeness of such information, and nothing contained in this Prospectus is, or shall be relied upon as, a promise or representation by any of the Banks or any selling agent as to the past, present or future. Without prejudice to any obligation of the Company to publish a supplementary prospectus pursuant to section 87G of the FSMA and PR 3.4.1 of the Prospectus Rules, neither the delivery of this Prospectus nor any sale made under this Prospectus shall, under any circumstances, create any implication that there has been no change in the business or affairs of the Company or of the Group taken as a whole since the date hereof or that the information contained herein is correct as of any time subsequent to its date.

The Company will update the information provided in this Prospectus by means of a supplement hereto if a significant new factor that may affect the evaluation by prospective investors of the Offer occurs prior to Admission or if this Prospectus contains any mistake or substantial inaccuracy. The Prospectus and any supplement thereto will be subject to approval by the FSA and will be made public in accordance with the Prospectus Rules. If a supplement to the Prospectus is published prior to Admission, investors shall have the right to withdraw their subscriptions made prior to the publication of such supplement. Such withdrawal must be done within the time limits set out in the supplement (if any) (which shall not be shorter than two clear business days after publication of such supplement).

The contents of this Prospectus are not to be construed as legal, business or tax advice. Each prospective investor should consult his or her own lawyer, financial adviser or tax adviser for legal, financial or tax advice in relation to any purchase or proposed purchase of Ordinary Shares.

No person has been authorised to give any information or make any representation other than those contained in this document and, if given or made, such information or representation must not be relied upon as having been authorised by or on behalf of the Company, the Directors, the Selling Shareholder or any of the Banks.

This Prospectus is not intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by any of the Company, the Directors, the Selling Shareholder or any of the Banks or any of their representatives that any recipient of this Prospectus should purchase the Offer Shares. Prior to making any decision as to whether to purchase the Offer Shares, prospective investors should read this Prospectus in its entirety and, in particular, Part II: "*Risk Factors*". In making an investment decision, prospective investors must rely upon their own examination of the Company and the terms of this Prospectus, including the risks involved.

Investors who purchase Offer Shares in the Offer will be deemed to have acknowledged that: (i) they have not relied on any of the Banks or any person affiliated with any of them in connection with any investigation of the accuracy of any information contained in this Prospectus or their investment decision; and (ii) they have relied solely on the information contained in this Prospectus; and (iii) no person has been authorised to give any information or to make any representation concerning the Group or the Ordinary Shares (other than as contained in this Prospectus) and, if given or made, any such other information or representation should not be relied upon as having been authorised by the Company, the Directors, the Selling Shareholder or any of the Banks.

None of the Company, the Directors, the Selling Shareholder or any of the Banks or any of their representatives is making any representation to any offeree or purchaser of the Offer Shares regarding the legality of an investment by such offeree or purchaser.

In connection with the Offer, the Banks and any of their affiliates, acting as investors for their own accounts, may purchase Offer Shares, and in that capacity may retain, purchase, sell, offer to sell or otherwise deal for its own accounts in such Offer Shares and other securities of the Company or related investments in connection with the Offer or otherwise. Accordingly, references in this Prospectus to the Offer Shares being offered, acquired, placed or otherwise dealt in should be read as including any issue or offer to, or acquisition, placing or dealing by any Bank and any of its affiliates acting as an investor for its

own accounts. The Banks do not intend to disclose the extent of any such investment or transactions otherwise than in accordance with any legal or regulatory obligations to do so.

The Banks and any of their respective affiliates may have engaged in transactions with, and provided various investment banking, financial advisory and other services for the Company and the Selling Shareholder, for which they would have received customary fees. The Banks and any of their respective affiliates may provide such services to the Company and the Selling Shareholder and any of their respective affiliates in the future.

Presentation of financial information

The combined financial information presented in this prospectus has been prepared for the combined group which comprises the Company and its subsidiaries. The combined financial information has been prepared in accordance with the requirements of the PD regulation and the Listing Rules in accordance with the basis of preparation included in Note 1, Accounting policies, in the Group's historical financial information included in Part XIII: "*Financial Information*". As described in basis of preparation, the combined financial information has been prepared in accordance with International Financial Reporting Standards ("**IFRS**") as adopted by the European Union ("**EU**") except for the inclusion, in the preparation of the combined financial information, of certain costs incurred by the RBS Group in respect of services provided to the Group that were not invoiced by the RBS Group. The Conceptual Framework for Financial Reporting, paragraph 4.49, gives guidance that expenses should be recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase in a liability has arisen. As there is no contractual liability to pay and therefore no liability has arisen in connection with these costs, the costs would not be recorded in the combined financial information of the Group under IFRS. The combined financial information includes these costs in order to present the cost base of the Group during the period covered by the combined financial information. See "*Basis of preparation*" in the Group's historical financial information included in Part XIII: "*Financial Information*" of this prospectus for more information.

Throughout this Prospectus the Group presents its results of operations in a format that is different in presentation from the combined income statements in the Group's historical financial information included in Part XIII: "*Financial Information*" of this prospectus. The Board believes the financial information which presents the Group's ongoing operations separate from its run-off and restructuring activities, better represent the underlying performance of the ongoing business and are consistent with how the Group has historically evaluated the business (refer to Note 4 in the Group historical financial information) and how the Group intends to report its results of operations in the future.

Return on tangible equity

The Group uses return on tangible equity as a supplemental measure of its performance and believes it is relevant to the evaluation of companies in its industry.

The Group calculates return on tangible equity as adjusted profit after tax from ongoing operations divided by weighted average tangible invested equity, as adjusted to reflect the weighted average value of dividends paid in 2012.

Profit after tax is adjusted to exclude run-off operations and restructuring and other one-off costs and is stated after charging tax (using UK standard tax rate).

The calculation of return on tangible equity is as follows:

	Six months ended 30 June 2012	Year ended 31 December		
		2011	2010	2009
	£ Million	£ Million	£ Million	£ Million
Profit/(loss) for the period	82.8	249.0	(271.9)	133.1
Adjusted for:				
Operating (profit)/loss of run-off activities	(1.2)	23.9	140.7	165.1
Restructuring and other one-off costs	108.7	54.0	29.0	80.0
Gain recognized on disposal of subsidiary and joint venture	—	(1.6)	—	(216.1)
Taxation	23.7	93.9	(106.2)	(0.9)
Adjusted profit before tax—ongoing operations	214.0	419.2	(208.4)	161.2
Tax (charge)/credit on Adjusted profit before tax—ongoing operations	(52.4)	(111.1)	58.4	(45.1)
Adjusted profit after tax from ongoing operations	**161.6**	**308.1**	**(150.0)**	**116.1**
Opening invested equity	3,612.8	3,223,6	3,322.1	2,931.6
Less: Goodwill and intangible assets	(365.8)	(286.1)	(290.3)	(382.5)
Opening tangible invested equity	3,247.0	2,937.5	3,031.8	2,549.1
Closing invested equity	2,905.7	3,612.8	3,223.6	3,322.1
Less: Goodwill and intangible assets	(390.9)	(365.8)	(286.1)	(290,3)
Closing tangible invested equity	2,514.8	3,247.0	2,937.5	3,031.8
Average tangible invested equity	**2,880.9**	**3,092.3**	**2,984.7**	**2,790.5**
Adjustment for time weighting of dividends paid	288.8	—	—	—
Weighted average invested equity	**3,169.6**	**3,092.3**	**2,984.7**	**2,790.5**
Return on tangible equity	**5.1%**	**10.0%**	**(5.0)%**	**4.2%**
Annualised return on tangible equity	**10.2%**			

Return on tangible equity is not a measurement of performance under IFRS and investors should not consider this measure as an alternative to other measures of performance under IFRS. This information has been disclosed in this Prospectus to permit a more complete and comprehensive analysis of the Group's operating performance relative to other companies. Because all companies do not calculate these measures identically, the Group's presentation of this measure may not be comparable to similarly titled measures of other companies.

Adjusted earnings per share

The Group uses adjusted earnings per share as a supplemental measure of its performance and believes it is relevant to the evaluation of companies in its industry. Adjusted earnings per share is calculated as the adjusted profit after tax from ongoing operations divided by the weighted average number of ordinary shares outstanding expressed as a percentage.

Adjusted earnings per share is not a measurement of performance under IFRS and investors should not consider this measure as an alternative to other measures of performance under IFRS. This information has been disclosed in this Prospectus to permit a more complete and comprehensive analysis of the Group's operating performance relative to other companies. Because all companies do not calculate these measures identically, the Group's presentation of this measure may not be comparable to similarly titled measures of other companies.

Rounding

Percentages and certain amounts included in this Prospectus have been rounded for ease of presentation. Accordingly, figures shown as totals in certain tables may not be the precise sum of the figures that precede them.

Currencies

Unless otherwise indicated, in this Prospectus, all references to:

- "**pounds sterling**" or "**£**" are to the lawful currency of the United Kingdom;
- "**US dollars**", "**dollars**", "**US$**" or "**cents**" are to the lawful currency of the United States; and
- "**euros**" or "**€**" are to the lawful currency of the European Union (as adopted by certain member states).

Unless otherwise indicated, the financial information contained in this Prospectus has been expressed in pounds sterling. For all members of the Group in the UK, the functional currency is the pound and the Group presents its financial statements in pounds sterling.

The basis of translation of foreign currency transactions and amounts in the financial information set out in Part XII: "*Operating and Financial Review*" is described in that Part. Information derived from this financial information set out elsewhere in this document has been translated on the same basis.

Forward-looking statements

Certain information contained in this Prospectus including any information as to the Group's strategy, plans or future financial or operating performance constitute "forward-looking statements". These forward-looking statements may be identified by the use of forward-looking terminology, including the terms "believes", "estimates", "anticipates", "projects", "expects", "intends", "aims", "plans", "predicts", "may", "will", "seeks" or "should" or, in each case, their negative or other variations or comparable terminology, or by discussions of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this Prospectus and include statements regarding the intentions, beliefs or current expectations of the Directors concerning, amongst other things: the Company's results of operations, financial condition, prospects, growth, strategies and the industry in which the Group operates. Examples of forward-looking statements include financial targets which are contained in this Prospectus specifically with respect to return on tangible equity, the Group's combined operating ratio, the combined operating ratio for the Group's commercial business, and cost savings, each of which are described in further detail in Part VII "*Information on the Company and the Group—Description of the Business of the Company and the Group—Strategy*".

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future or are beyond the Group's control. Forward-looking statements are not guarantees of future performance. The Company's actual results of operations, financial condition and the development of the business sector in which the Group operates may differ materially from those suggested by the forward-looking statements contained in this Prospectus including, but not limited to, UK domestic and global economic business conditions, market-related risks such as fluctuations in interest rates and exchange rates, the policies and actions of regulatory authorities (including changes related to capital and solvency requirements or the Ogden discount rate), the impact of competition, currency changes, inflation, deflation, the timing impact and other uncertainties of future acquisitions or combinations within relevant industries, as well as the impact of tax and other legislation and other regulations in the jurisdictions in which the Group and its affiliates operate. In addition, even if the Company's actual results of operations, financial condition, and the development of the business sector in which the Group operates are consistent with the forward-looking statements contained in this document, those results or developments may not be indicative of results or developments in subsequent periods.

Prospective investors are advised to read, in particular, the parts of this Prospectus entitled Part II: "*Risk Factors*", Part VII: "*Information on the Company and the Group*", Part IX: "*Regulatory Overview*", Part XII: "*Operating and Financial Review*" and Part XIII: "*Financial Information*" for a more complete discussion of the factors that could affect the Group's future performance and the industry in which the Group operates. In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements in this Prospectus may not occur.

The forward-looking statements contained in this Prospectus speak only as of the date of this Prospectus. The Company, the Directors, the Selling Shareholder, and each of the Banks expressly disclaim any obligations or undertaking to update or revise publicly any forward-looking statements, whether as a result

of new information, future events or otherwise, unless required to do so by applicable law, the Prospectus Rules, the Listing Rules, or the Disclosure and Transparency Rules of the FSA.

Market, economic and industry data

This Prospectus contains information regarding the Group's business and the industry in which it operates and competes which the Company has obtained from various third-party sources. In certain cases, the Company has made statements on the basis of information obtained from third-party sources that the Board believes are reliable including:

- Acturis, eTrading Discussion, 3 July 2012 ("**Acturis Study**")
- Association of British Insurers, UK Insurance—Key Facts, September 2011 ("**ABI Key Facts 2011**")
- Association of British Insurers, Property Income and Outgoings: UK Property Operating Ratios, 2010 ("**ABI UK Operating Ratios**")
- Association of British Insurers, Rankings by Class based on UK Gross Written Premiums in 2010, 2010 ("**ABI Rankings 2010**")
- AM Best Europe—Information Services Ltd.
- *Associazione Nazionale fra le Imprese Assicuratrici, Premi del lavoro diretto italiano* 2011, 2012 ("**ANIA Report 2011**")
- *Associazione Nazionale fra le Imprese Assicuratrici, L'Assicurazione Italiana* 2011-2012, 2012 ("**ANIA Italiana Report**")
- Datamonitor UK SME Insurance 2011, November 2011 ("**Datamonitor UK SME Insurance 2011 Report**")
- Department of Transport Statistics, Licensed vehicles by body type, Great Britain, quarterly from 1994, 14 June 2012 ("**Department of Transport Statistics 2012**")
- Ernst and Young, UK Motor Insurance Seminar, May 2012 ("**Ernst and Young UK Motor Insurance Seminar**")
- European Commission, Interim forecast: euro area in mild recession with signs of stabilisation, 23 February 2012 ("**European Commission Press Release**")
- Eurostat, Number of private households by household composition, number of children and age of youngest child, 19 July 2012 ("**Eurostat 2012**")
- *Gesamtverband der Deutschen Versicherungswirtschaft e.V. (GDV), Anteile der Vertriebswege am Beitragsaufkommen 2010* (2011) ("**GDV Insurance Study 2011**")
- *Gesamtverband der Deutschen Versicherungswirtschaft e.V. (GDV), Bruttobeitragseinnahner des Inländischen Direktgeschäfts, 2010* ("**GDV Direct Market Study 2010**")
- *Gesamtverband der Deutschen Versicherungswirtschaft e.V. (GDV), Bruttobeitragseinnahner des Inländischen Direktgeschäfts, 2011* ("**GDV Direct Market Study 2011**")
- *Gesamtverband der Deutschen Versicherungswirtschaft e.V. (GDV), Pressekolloquium, 18 April 2012* ("**GDV 18 April 2012 Study**")
- Motor & Home market share data © GfK NOP Financial Research Survey (FRS) 3 months ending December 2011, 6,901 adults interviewed for Motor and 7,234 for Home
- Retention rates GfK NOP Financial Research Survey (FRS) 6 months ending December 2011, 1,379 adults interviewed for Direct Line, 829 adults interviewed for Churchill and 126 adults interviewed for Privilege
- Cross product holdings GfK NOP Financial Research Survey (FRS) 12 months ending December 2011, 1,219 adults interviewed for Direct Line, 750 adults interviewed for Churchill and 61 adults interviewed for Privilege
- International Monetary Fund, Global recovery stalls downside risks intensify, 24 January 2012 ("**IMF Press Release**")
- Mintel Group Ltd, Vehicle Recovery—UK, December 2011 ("**Mintel Study 2011**")

- TNS, *Advertising tracking anno 2011*, 2011 ("**TNS**")
- Nunwood Brand Tracking, Motor and Home Top 3 Box Consideration Scores, January to December 2011 ("**Nunwood Brand Tracking Study**")
- Towers Watson, Survey of 10,000 Group employees, 2011 ("**Towers Watson 2011 Survey**")
- United Nations Economic Commission for Europe Transport Division Database, Passenger Vehicles (number) at 31 December by Vehicle Category, Country and Year ("**United Nations Statistical Database**")

Where information has been sourced from a third party it has been accurately reproduced and as far as the Company is aware and is able to ascertain from information published by that third party, no facts have been omitted which would render the reproduced information inaccurate or misleading.

No incorporation of website information

The contents of the Group's websites do not form any part of this Prospectus.

US considerations

Available information

The Company has agreed that, for so long as any of the Ordinary Shares are "restricted securities" as defined in Rule 144(a)(3) under the Securities Act, the Company will, during any period in which it is neither subject to Section 13 or 15(d) of the US Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), nor exempt from reporting under the Exchange Act pursuant to Rule 12g3-2(b) thereunder, make available to any holder or beneficial owner of such restricted securities or to any prospective purchaser of such restricted securities designated by such holder or beneficial owner, upon the request of such holder, beneficial owner or prospective purchaser, the information required to be delivered pursuant to Rule 144A(d)(4) under the Securities Act.

Service of process and enforcement of civil liabilities

The Company is incorporated under the laws of England and Wales. Service of process upon Directors and Senior Management of the Company, many of whom reside outside the United States, may be difficult to obtain within the United States. Furthermore, since most directly owned assets of the Company are outside the United States, any judgment obtained in the United States against it may not be collectible within the United States. There is doubt as to the enforceability of certain civil liabilities under US federal securities laws in original actions in English courts, and, subject to certain exceptions and time limitations, English courts will treat a final and conclusive judgment of a US court for a liquidated amount as a debt enforceable by fresh proceedings in the English courts.

Certain terms used in this Prospectus are defined, and certain technical and other terms used in this Prospectus are explained, in Part XVII: "*Definitions*" and Part XVIII: "*Glossary*".

PART VI—DETAILS OF THE OFFER

1. Ordinary Shares Subject to the Offer

Pursuant to the Offer, the Selling Shareholder has authorised the sale, in aggregate, of up to 500,000,000 Ordinary Shares (the "**Offer Shares**"), and estimates it will receive proceeds of £755.3 million (assuming the number of Offer Shares sold is at the mid-point between 25.0% and 33.3% of the total number of issued Ordinary Shares, no exercise of the Over-allotment Option and that the Offer Price is set at the mid-point of the Price Range), net of aggregate underwriting commissions, other estimated fees and expenses, VAT and stamp duty of approximately £21.2 million. The maximum number of Offer Shares represents approximately 33.3% of the issued share capital of the Company.

In addition, Over-allotment Shares (representing approximately 15% of the maximum number of Ordinary Shares comprised in the Offer) are being made available by the Selling Shareholder pursuant to the Over-allotment Option described below.

The Company will bear one-off fees and expenses of an amount of approximately £16.9 million (excluding VAT and stamp duty) in connection with Admission and the Offer, and will receive no Offer proceeds. The Selling Shareholder will bear approximately £16.7 million (excluding VAT and stamp duty) in commissions payable, excluding any discretionary commissions, and other estimated fees and expenses in connection with the Offer (assuming the number of Offer Shares sold is at the mid-point between 25.0% and 33.3% of the total number of issued Ordinary Shares, no exercise of the Over-allotment Option and that the Offer Price is set at the mid-point of the Price Range) and will receive all of the Offer proceeds.

The Selling Shareholder has also agreed, in its absolute discretion, to pay a discretionary commission of up to £6.6 million (assuming the number of Offer Shares sold is at the mid-point between 25.0% and 33.3% of the total number of issued Ordinary Shares, no exercise of the Over-allotment Option and that the Offer Price is set at the mid-point of the Price Range).

2. The Offer

The Offer is made by way of:

(a) an Institutional Offer: (i) to certain institutional and professional investors in the United Kingdom and elsewhere outside the United States in reliance on Regulation S under the Securities Act; and (ii) to QIBs in the United States in reliance on Rule 144A under the Securities Act or another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act; and

(b) an Intermediaries Offer to the Intermediaries for onward distribution to retail investors in the United Kingdom, the Channel Islands and the Isle of Man.

Under the Offer, all the Offer Shares will be sold, payable in full at the Offer Price.

None of the Institutional Banks is acting as underwriter of the Intermediaries Offer. Barclays is not acting as coordinator, sponsor, bookrunner, underwriter, manager or arranger of or in connection with the Institutional Offer.

The distribution of this Prospectus and the offer and sale of the Offer Shares are subject to the restrictions set out in "*Selling Restrictions*" below.

When admitted to trading, the Ordinary Shares will be registered with ISIN number GB00B89W0M42 and SEDOL number B89W0M4. The rights attaching to the Ordinary Shares will be uniform in all respects and they will form a single class for all purposes.

Immediately following Admission, it is expected that not less than 25.0% and up to approximately 33.3% of the Company's issued ordinary share capital will be held in public hands (within the meaning of Listing Rule 6.1.19) assuming that no Over-allotment Shares are acquired pursuant to the Over-allotment Option (increasing to between approximately 28.8% and 38.3% if the maximum number of Over-allotment Shares are acquired pursuant to the Over-allotment Option).

3. Reasons for the Offer and Admission

In 2009, as a condition to its receipt of State Aid, the Selling Shareholder committed to the European Commission to undertake a series of measures, which include disposing of its interest in the Group. To comply with this requirement, the RBS Group must cede control of the Group by the end of 2013 and must have divested its entire interest by the end of 2014. The reason for the Offer is that the Selling Shareholder determined that its preferred strategy to satisfy its commitment to the European Commission was a divestment by way of an IPO of the Company (together with subsequent sales of its residual post-Admission interest in the Company).

In addition, the Board believes that Admission will benefit the Company as it will:

- give the Company access to a wider range of capital-raising options which may be of use in the future; and
- assist in recruiting, retaining and incentivising key management and employees.

No expenses will be charged by the Company or the Selling Shareholder to any purchasers of the Offer Shares.

4. The Selling Shareholder

The Selling Shareholder is The Royal Bank of Scotland Group plc (registered number SC45551) whose registered office is at 36 St Andrew Square, Edinburgh, EH2 2YB. The Company is, and prior to Admission will continue to be, a wholly owned subsidiary of the Selling Shareholder.

5. Offer Price and Bookbuilding

The Offer Price will be determined by the Selling Shareholder in consultation with the Joint Global Coordinators and the Company and is expected to be announced on or about 11 October 2012. The Pricing Statement, which will contain the Offer Price, will be published in printed form and available free of charge at Churchill Court, Westmoreland Road, Bromley BR1 1DP.

It is currently expected that the Offer Price will be within the Price Range, but this range is indicative only and the Offer Price may be set within, above or below it. A number of factors will be considered in deciding the Offer Price including the level and the nature of the demand for Ordinary Shares and the objective of encouraging the development of an orderly and liquid after-market in the Ordinary Shares. The Offer Price will be established at a level determined in accordance with these arrangements, taking into account indications of interest received (whether before or after the times and/or dates stated) from persons (including market-makers and fund managers) connected with the Joint Global Coordinators. The Company, the Directors, the Selling Shareholder and the Joint Global Coordinators reserve the right to increase or decrease the aggregate number of Ordinary Shares sold under the Offer. If the Price Range changes prior to the announcement of the final Offer Price, the revised Price Range will be announced and advertised as soon as possible and the Company will publish a supplementary prospectus and each applicant may exercise their withdrawal rights as set out in "*Withdrawal Rights*" below.

The Managers will solicit from prospective investors indications of interest in acquiring Ordinary Shares under the Institutional Offer. Prospective institutional investors will be required to specify the number of Ordinary Shares which they would be prepared to acquire either at specified prices or at the Offer Price (as finally determined). Subject to the Joint Bookrunners, the Company and the Selling Shareholder determining allocations, there is no minimum or maximum number of Ordinary Shares which can be applied for.

Applications are expected to be sought by the Intermediaries from their selected clients under the Intermediaries Offer for Ordinary Shares on the basis that the exact number of Ordinary Shares the subject of such applications will vary depending on the final Offer Price. A global application will then be made by the Intermediaries on behalf of their clients, through Barclays, and this demand will be taken into account by the Joint Bookrunners, the Company and the Selling Shareholder alongside indications of interest in the Institutional Offer in conducting the bookbuilding process described above in respect of the Offer.

Allocations under the Institutional Offer will be determined at the Joint Bookrunners' discretion, following consultation with the Selling Shareholder and the Company. Allocations under the

Intermediaries Offer will be determined at the discretion of the Joint Bookrunners and Barclays, following consultation with the Selling Shareholder and the Company. A number of factors will be considered in determining the basis of allocation, including the level and nature of demand for Ordinary Shares in the Offer and the objective of encouraging an orderly and liquid after-market in the Ordinary Shares. If there is excess demand for Ordinary Shares, allocations may be scaled down at the Joint Bookrunners' discretion following consultation with the Selling Shareholder and applicants may be allocated Ordinary Shares having an aggregate value which is less than the sum applied for. The Joint Bookrunners may allocate such shares at their discretion (subject to consultation with the Selling Shareholder and the Company) and there is no obligation for the Joint Bookrunners to allocate such shares proportionately.

Completion of the Offer will be subject, inter alia, to the determination of the Offer Price and the Selling Shareholder's decision to proceed with the Offer. It will also be subject to the satisfaction of conditions contained in the Underwriting Agreement including admission occurring and to the Underwriting Agreement not having been terminated. The Offer cannot be terminated once unconditional dealings in the Ordinary Shares have commenced. Further details of the Underwriting Agreement are set out in Part XVI: "*Additional Information—Underwriting and Placing Arrangements*".

6. The Institutional Offer

Under the Institutional Offer, Ordinary Shares will be offered to: (i) certain institutional and professional investors in the United Kingdom and elsewhere outside the United States in reliance on Regulation S under the Securities Act; and (ii) to QIBs in the United States in reliance on Rule 144A under the Securities Act or another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Certain restrictions that apply to the distribution of this document and the offer and sale of the Ordinary Shares in jurisdictions outside the United Kingdom are described below in paragraph 17 "*Selling Restrictions*".

The latest time and date for indications of interest in acquiring Ordinary Shares under the Institutional Offer is set out in Part IV: "*Expected Timetable of Principal Events and Offer Statistics*", but that time may be extended at the discretion of the Joint Global Coordinators (with the agreement of the Company and the Selling Shareholder).

Participants in the Institutional Offer will be advised verbally or by electronic mail of their allocation as soon as practicable following pricing and allocation. Prospective investors in the Institutional Offer will be contractually committed to acquire the number of Ordinary Shares allocated to them at the Offer Price and, to the fullest extent permitted by law, will be deemed to have agreed not to exercise any rights to rescind or terminate, or otherwise withdraw from, such commitment.

7. The Intermediaries Offer

Members of the general public will not be able to apply directly for Ordinary Shares in the Offer. They may, however, be eligible to apply for Ordinary Shares through the Intermediaries by following their relevant application procedures, by no later than 5.00 p.m. on 9 October 2012. The Intermediaries may not permit underlying applicants to make more than one application under the Intermediaries Offer (whether on their own behalf or through other means, including, but without limitation, through a trust or pension plan).

Only the Intermediaries' retail investor clients in the United Kingdom, the Channel Islands and the Isle of Man are eligible to participate in the Intermediaries Offer. No Ordinary Shares allocated under the Intermediaries Offer will be registered in the name of any person whose registered address is outside the United Kingdom, the Channel Islands and the Isle of Man except in certain limited circumstances with the consent of Barclays and the Joint Global Coordinators.

An application for Ordinary Shares in the Intermediaries Offer means that the applicant agrees to acquire the Ordinary Shares at the Offer Price. Each applicant must comply with the appropriate money laundering checks required by the relevant Intermediary. Where an application is not accepted or there are insufficient Ordinary Shares available to satisfy an application in full, the relevant Intermediary will be obliged to refund the applicant as required and all such refunds shall be made without interest and shall be despatched by post to the return address given by the applicant and will be despatched at the relevant Intermediary's risk. The Company, the Selling Shareholder and the

Banks accept no responsibility with respect to the obligation of the Intermediaries to refund monies in such circumstances.

In making an application, each Intermediary will also be required to represent and warrant that they are not located in the United States and are not acting on behalf of anyone located in the United States.

The Intermediaries may prepare certain materials for distribution or may otherwise provide information or advice to retail investors in the United Kingdom, the Channel Islands and the Isle of Man, subject to the terms of the Intermediaries Agreement. Any such materials, information or advice are solely the responsibility of the Intermediaries and shall not be reviewed or approved by any of the Banks, the Selling Shareholder or the Company. Any liability relating to such documents shall be for the Intermediaries only.

Each Intermediary will be informed by Barclays by fax or e-mail of the aggregate number of Ordinary Shares allocated in aggregate to its underlying clients (or to the Intermediary itself) and the total amount payable in respect thereof. The aggregate allocation of Offer Shares as between the Institutional Offer and the Intermediaries Offer will be determined by the Joint Bookrunners after consultation with the Company and the Selling Shareholder. Allocations as between Intermediaries will be determined by the Joint Bookrunners and Barclays after consultation with the Company and the Selling Shareholder. Under the Intermediaries Offer, Ordinary Shares will be offered outside of the United States only in offshore transactions as defined in, and in relation on, Regulation S.

The publication of the Prospectus and any other actions of the Company, the Selling Shareholder, the Banks, the Intermediaries or other persons in connection with the Offer should not be taken as any representation or assurance as to the basis on which the number of Ordinary Shares to be offered under the Intermediaries Offer or allocations within the Intermediaries Offer will be determined and all liabilities for any such action or statement are hereby disclaimed, by the Company, the Selling Shareholder and the Banks.

Pursuant to the Intermediaries Agreement, the Intermediaries have undertaken to make payment on their own behalf (not on behalf of any other person) of the consideration for the Ordinary Shares allocated, at the Offer Price, to Barclays in accordance with details to be communicated on or after the time of allocation, by means of the CREST system against delivery of the Ordinary Shares at the time and/or date set out in Part IV: "*Expected Timetable of Principal Events and Offer Statistics*", or at such other time and/or date after the day of publication of the Offer Price as may be agreed by the Company, the Selling Shareholder and the Joint Global Coordinators and notified to the Intermediaries by Barclays. The issue of any refund cheques to underlying applicants will be the sole responsibility of the Intermediaries.

The Intermediaries Agreement provides for the Intermediaries to be paid a commission by the Selling Shareholder in respect of the Offer Shares allocated to, and paid for by, them pursuant to the Intermediaries Offer. Further details of the terms of the Intermediaries Agreement are set out in Part XVI: "*Additional Information—Underwriting and Placing Arrangements*".

8. Withdrawal Rights

In the event that the Company is required to publish any supplementary prospectus, applicants who have applied for Ordinary Shares in the Offer shall have at least two clear business days following the publication of the relevant supplementary prospectus within which to withdraw their offer to acquire Ordinary Shares in the Offer in its entirety. The right to withdraw an application to acquire Ordinary Shares in the Offer in these circumstances will be available to all investors in the Offer. If the application is not withdrawn within the stipulated period any offer to apply for Ordinary Shares in the Offer will remain valid and binding.

Details of how to withdraw an application will be made available if a supplementary prospectus is published. Applicants who have applied via an Intermediary should contact the relevant Intermediary for details of how to withdraw an application.

9. Pricing

All Ordinary Shares sold pursuant to the Offer will be sold, payable in full, at the Offer Price. The number of Ordinary Shares allocated and the basis of allocation are expected to be announced on

11 October 2012, at which point the Intermediaries will be advised, amongst other matters, of the Offer Price and the number of Ordinary Shares allocated to them under the Offer.

Upon notification of any allocation, prospective investors will be contractually committed to acquire the number of Ordinary Shares allocated to them at the Offer Price and, to the fullest extent permitted by law, will be deemed to have agreed not to exercise any rights to rescind or terminate, or otherwise withdraw from, such commitment. Dealing may not begin before notification is made.

10. Underwriting Arrangements

The Company, the Selling Shareholder, the Directors and the Banks have entered into the Underwriting Agreement pursuant to which, on the terms and subject to certain conditions contained in the Underwriting Agreement which are customary in agreements of this nature, the Institutional Offer Underwriters have severally agreed to underwrite the sale of the Institutional Offer Shares, and the Intermediaries Offer Underwriter has agreed to underwrite the sale of the Intermediaries Offer Shares, in each case, as allocated under the Offer.

The Offer is conditional upon, *inter alia*, Admission occurring not later than 8.00 a.m. on 16 October 2012 (or such later date and time as the Company may agree with the Joint Sponsors) and the Underwriting Agreement becoming unconditional in all respects and not having been terminated in accordance with its terms.

The Underwriting Agreement provides for the Institutional Offer Underwriters to be paid a commission in respect of the Institutional Offer Shares sold and any Over-allotment Shares sold following exercise of the Over-allotment Option. Any commissions received by the Institutional Offer Underwriters may be retained and any Ordinary Shares acquired by them may be retained or dealt in, by them, for their own benefit.

The Underwriting Agreement provides for the Intermediaries Offer Underwriter to be paid a commission in respect of the Intermediaries Offer Shares sold. Any commissions received by the Intermediaries Offer Underwriter may be retained and any Ordinary Shares acquired by it may be retained or dealt in, by them, for their own benefit.

Under the terms and conditions of the Underwriting Agreement, the Joint Sponsors have severally agreed to provide certain assistance to the Company in connection with Admission.

The Underwriting Agreement contains provisions entitling the Joint Global Coordinators to terminate the Offer (and the arrangements associated with it) at any time prior to (but not after) Admission in certain circumstances, and entitling the Selling Shareholder and the Company to terminate the Offer (and the arrangements associated with it) at any time prior to the Pricing Statement. If these termination rights are exercised, the Offer will lapse and any moneys received in respect of the Offer will be returned to applicants without interest.

Allocations under the Institutional Offer will be determined at the discretion of the Joint Bookrunners following consultation with the Selling Shareholder and the Company. Allocations under the Intermediaries Offer will be determined at the discretion of the Joint Bookrunners and Barclays, following consultation with the Selling Shareholder and the Company. All Offer Shares sold pursuant to the Offer will be sold, payable in full, at the Offer Price. Liability for UK stamp duty and stamp duty reserve tax is described in Part XVI: "*Additional Information—UK Taxation*".

Further details of the terms of the Underwriting Agreement are set out in Part XVI: "*Additional Information—Underwriting and Placing Arrangements*".

11. Stabilisation and Over-allotment Option

In connection with the Institutional Offer, the Stabilising Manager, or any of its agents or affiliates, may (but will be under no obligation to), to the extent permitted by applicable law, over-allot Ordinary Shares or effect other transactions with a view to supporting the market price of the Ordinary Shares at a higher level than that which might otherwise prevail in the open market.

The Stabilising Manager is not required to enter into such transactions and such transactions may be effected on any securities market, over-the-counter market, stock exchange or otherwise and may be undertaken at any time during the period from the date of the commencement of conditional dealings of the Ordinary Shares on the London Stock Exchange and ending no later than 30 calendar days

thereafter. However, there will be no obligation on the Stabilising Manager or any of its agents or affiliates to effect stabilising transactions and there is no assurance that stabilising transactions will be undertaken. Such stabilisation, if commenced, may be discontinued at any time without prior notice. In no event will measures be taken to stabilise the market price of the Ordinary Shares above the Offer Price. Except as required by law or regulation, neither the Stabilising Manager nor any of its agents or affiliates intends to disclose the extent of any over-allotments made and/or stabilisation transactions conducted in relation to the Institutional Offer.

In connection with the Institutional Offer, the Stabilising Manager may, for stabilisation purposes, over-allot Ordinary Shares up to a maximum of 15% of the total number of Offer Shares. For the purposes of allowing the Stabilising Manager to cover short positions resulting from any such over-allotments and/or from sales of Ordinary Shares effected by it during the stabilising period, the Selling Shareholder has granted the Over-allotment Option to the Stabilising Manager (on behalf of the Institutional Offer Underwriters) pursuant to which the Stabilising Manager may require the Selling Shareholder to make available additional Ordinary Shares up to a maximum of 15% of the aggregate number of Offer Shares (before any utilisation of the Over-allotment Option) at the Offer Price. The Over-allotment Option is exercisable in whole or in part, upon notice by the Stabilising Manager at any time on or before the thirtieth calendar day after the commencement of conditional dealings of the Ordinary Shares on the London Stock Exchange. Any Over-allotment Shares made available pursuant to the Over-allotment Option will rank pari passu in all respects with the Ordinary Shares, including for all dividends and other distributions declared, made or paid on the Ordinary Shares, will be purchased on the same terms and conditions as the Ordinary Shares being sold in the Institutional Offer and will form a single class for all purposes with the other Ordinary Shares.

12. Lock-up Arrangements

Each of the Company, the Selling Shareholder and the Directors has agreed to certain lock-up arrangements.

Pursuant to the Underwriting Agreement, the Company has agreed that, subject to certain exceptions, during the period of 180 days from the date of Admission, it will not, without the prior written consent of the Joint Global Coordinators, issue, offer, sell or contract to sell, or otherwise dispose of any Ordinary Shares (or any interest therein or in respect thereof) or enter into any transaction with the same economic effect as any of the foregoing. Further details are set out in Part XVI: "*Additional Information—Underwriting Agreement*".

Each of the Directors has agreed that, subject to certain exceptions, during the period of 360 days from the date of Admission, he/she will not, without the prior written consent of the Joint Global Coordinators, offer, sell or contract to sell, or otherwise dispose of any Ordinary Shares (or any interest therein in respect thereof) or enter into any transaction with the same economic effect as any of the foregoing. Further details are set out in Part XVI: "*Additional Information—Underwriting Agreement*".

Pursuant to the Underwriting Agreement, the Selling Shareholder has agreed that, subject to certain exceptions, during the period of 180 days from the date of Admission, it will not, without the prior written consent of the Joint Global Coordinators offer, sell or contract to sell, or otherwise dispose of any Ordinary Shares (or any interest therein in respect thereof) or enter into any transaction with the same economic effect as any of the foregoing.

Further details of these arrangements, which are contained in the Underwriting Agreement, are set out in Part XVI: "*Additional Information—Underwriting Agreement*".

13. Stock Lending Agreement

In connection with settlement and stabilisation, Goldman Sachs, as Stabilising Manager, has entered into a stock lending agreement (the "**Stock Lending Agreement**") with the Selling Shareholder pursuant to which the Stabilising Manager will be able to borrow up to 15% of the Offer Shares Ordinary Shares on Admission for the purposes, amongst other things of allowing the Stabilising Manager to settle, at Admission, over-allotments, if any, made in connection with the Offer. If the Stabilising Manager borrows any Ordinary Shares pursuant to the Stock Lending Agreement, it will be required to return equivalent shares to the Selling Shareholder in accordance with the terms of the Stock Lending Agreement.

14. Dealing Arrangements

It is expected that dealings in the Ordinary Shares will commence on a conditional basis on the London Stock Exchange at 8.00 a.m. on 11 October 2012. The earliest date for settlement of such dealings will be 16 October 2012. It is expected that Admission will become effective and that unconditional dealings in the Ordinary Shares will commence on the London Stock Exchange at 8.00 a.m. on 16 October 2012.

All dealings in Ordinary Shares prior to the commencement of unconditional dealings will be on a "when-issued basis", will be of no effect if Admission does not take place, and will be at the sole risk of the parties concerned. The above mentioned dates and times may be changed without further notice.

Each investor will be required to undertake to pay the Offer Price for the Ordinary Shares sold to such investor in such manner as shall be directed by the Joint Global Coordinators. Pricing information and other related disclosures will be published on the Company's website on 16 October 2012.

It is intended that, where applicable, definitive share certificates in respect of the Offer will be distributed from 23 October 2012 or as soon thereafter as is practicable. Temporary documents of title will not be issued. Dealings in advance of crediting of the relevant CREST stock account(s) shall be at the sole risk of the persons concerned.

15. CREST

CREST is a paperless settlement system enabling securities to be transferred from one person's CREST account to another's without the need to use share certificates or written instruments of transfer. The Company has applied for the Ordinary Shares to be admitted to CREST with effect from Admission and, also with effect from Admission, the Articles will permit the holding of Ordinary Shares under the CREST system. Accordingly, settlement of transactions in the Ordinary Shares following Admission may take place within the CREST system if any shareholder so wishes. CREST is a voluntary system and holders of Ordinary Shares who wish to receive and retain share certificates will be able to do so.

16. Conditionality of the Offer

The Offer is subject to the satisfaction of conditions which are customary for transactions of this type contained in the Underwriting Agreement, including Admission becoming effective by no later than 8.00 a.m. on 16 October 2012, determination of the Offer Price, and the Underwriting Agreement not having been terminated prior to Admission. See Part XVI: "*Additional Information—Underwriting and Placing Arrangements*" for further details about the underwriting arrangements.

The Selling Shareholder expressly reserves the right to determine, at any time prior to Admission, not to proceed with the Offer. If such right is exercised, the Offer (and the arrangements associated with it) will lapse and any monies received in respect of the Offer will be returned to applicants without interest.

17. Selling Restrictions

The distribution of this Prospectus and the offering and sale of Ordinary Shares in certain jurisdictions may be restricted by law and therefore persons into whose possession this Prospectus comes should inform themselves about and observe any such restrictions, including those in the paragraphs that follow. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction.

None of the Ordinary Shares may be offered for subscription, sale or purchase or be delivered, or be subscribed, sold or delivered, and this Prospectus and any other offering material in relation to the Ordinary Shares may not be circulated, in any jurisdiction where to do so would breach any securities laws or regulations of any such jurisdiction or give rise to an obligation to obtain any consent, approval or permission, or to make any application, filing or registration.

17.1 European Economic Area

In relation to each Relevant Member State, an offer to the public of any Ordinary Shares may not be made in that Relevant Member State, except that an offer to the public in that Relevant Member State of any Ordinary Shares may be made at any time under the following exemptions under the Prospectus Directive, if they have been implemented in that Relevant Member State:

(a) to any legal entity which is a qualified investor as defined under the Prospectus Directive;

(b) to fewer than 100, or, if the Relevant Member State has implemented the relevant provisions of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), subject to obtaining the prior consent of the Joint Global Coordinators; or

(c) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Ordinary Shares shall result in a requirement for the Company or any Joint Sponsor or Manager to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive and each person who initially acquires any Ordinary Shares or to whom any offer is made will be deemed to have represented, warranted and agreed to and with the Joint Sponsor or Manager and the Company that it is a qualified investor within the meaning of the law in that Relevant Member State implementing Article 2(1)(e) of the Prospectus Directive.

For the purposes of this provision, the expression an **offer to the public** in relation to any Ordinary Shares in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the Offer and any Ordinary Shares to be offered so as to enable an investor to decide to purchase any Ordinary Shares, as the same may be varied for that Relevant Member State by any measure implementing the Prospectus Directive in that Relevant Member State.

17.2 United States of America

This Prospectus is not an offer of securities for sale in the United States. The Ordinary Shares have not been, and will not be, registered under the Securities Act or with any securities regulatory authority of any state or other jurisdiction of the United States and may not be offered or sold in the United States except in transactions exempt from or not subject to the registration requirements of the Securities Act. Accordingly, the Joint Bookrunners may offer Ordinary shares (1) in the United States only through their US registered broker affiliates to persons reasonably believed to be QIBs in reliance on Rule 144A or pursuant to another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act or (2) outside the United States in offshore transactions in reliance on Regulation S under the Securities Act.

In addition, until 40 days after the commencement of the Offer, any offer or sale of Ordinary Shares within the United States by any dealer (whether or not participating in the Offer) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A or another available exemption from registration under the Securities Act.

Each purchaser of Ordinary Shares within the United States, by accepting delivery of this Prospectus, will be deemed to have represented, agreed and acknowledged that it has received a copy of this Prospectus and such other information as it deems necessary to make an investment decision and that:

(a) it is (i) a QIB within the meaning of Rule 144A, (ii) acquiring the Ordinary Shares for its own account or for the account of one or more QIBs with respect to whom it has the authority to make, and does make, the representations and warranties set forth herein, (iii) acquiring the Ordinary Shares for investment purposes, and not with view to further distribution of such Ordinary Shares, and (iv) aware, and each beneficial owner of the Ordinary Shares has been advised, that the sale of the Ordinary Shares to it is being made in reliance on Rule 144A or in reliance on another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act;

(b) it understands that the Ordinary Shares are being offered and sold in the United States only in a transaction not involving any public offering within the meaning of the Securities Act and that the Ordinary Shares have not been and will not be registered under the Securities Act or with any securities regulatory authority of any state or other jurisdiction of the United States and may not

be offered, sold, pledged or otherwise transferred except (i) to a person that it and any person acting on its behalf reasonably purchasing for its own account or for the account of a QIB in a transaction meeting the requirements of Rule 144A, or another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act, (ii) in an Offshore Transaction in accordance with Rule 903 or Rule 904 of Regulation S, (iii) pursuant to an exemption from registration under the Securities Act provided by Rule 144 thereunder (if available) or (iv) pursuant to an effective registration statement under the Securities Act, in each case in accordance with any applicable securities laws of any state of the United States. It further (A) understands that the Ordinary Shares may not be deposited into any unrestricted depositary receipt facility in respect of the Ordinary Shares established or maintained by a depositary bank, (B) acknowledges that the Ordinary Shares (whether in physical certificated form or in uncertificated form held in CREST) are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act and that no representation is made as to the availability of the exemption provided by Rule 144 for resales of the Ordinary Shares and (C) understands that the Company may not recognise any offer, sale, resale, pledge or other transfer of the Ordinary Shares made other than in compliance with the above-stated restrictions; and

(c) it understands that the Ordinary Shares (to the extent they are in certificated form), unless otherwise determined by the Company in accordance with applicable law, will bear a legend substantially to the following effect:

THE ORDINARY SHARES REPRESENTED HEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE US SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT") OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) TO A PERSON THAT THE SELLER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER, (2) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT, (3) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE) OR (4) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT FOR RESALES OF THE SHARES. NOTWITHSTANDING ANYTHING TO THE CONTRARY IN THE FOREGOING, THE ORDINARY SHARES REPRESENTED HEREBY MAY NOT BE DEPOSITED INTO ANY UNRESTRICTED DEPOSITARY RECEIPT FACILITY IN RESPECT OF THE ORDINARY SHARES ESTABLISHED OR MAINTAINED BY A DEPOSITARY BANK. EACH HOLDER, BY ITS ACCEPTANCE OF ORDINARY SHARES, REPRESENTS THAT IT UNDERSTANDS AND AGREES TO THE FOREGOING RESTRICTIONS.

The Company, the Underwriters and their affiliates and others will rely on the truth and accuracy of the foregoing acknowledgements, representations and agreements.

17.3 Japan

The Ordinary Shares have not been and will not be registered under the Financial Instruments and Exchange Law as amended; the ("**FIEL**"). The Ordinary Shares may not be offered or sold directly or indirectly, in Japan or to, or for the benefit of, any resident in Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan), or to others for reoffering or resale, directly or indirectly, in Japan or to, or for the benefit of, a resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the FIEL and any other applicable laws, regulations and ministerial guidelines of Japan.

17.4 Australia

This Prospectus has not been, and will not be, lodged with the Australian Securities and Investments Commission as a disclosure document for the purpose of the Corporations Act 2001. This Prospectus does not purport to include the information required of a disclosure document under Chapter 6D of the Corporations Act 2001.

No Ordinary Share may be offered for sale (or transferred, assigned or otherwise alienated) to investors in Australia for at least 12 months after this issue, except in circumstances where disclosure to investors is not required under Chapter 6D of the Corporations Act 2001 or unless a disclosure document that complies with the Corporations Act 2001 is lodged with the Australian Securities and Investments Commission.

Each investor acknowledges the above and, by applying for securities under this Prospectus, gives an undertaking not to sell those securities (except in the circumstances referred to above) for 12 months after their issue.

17.5 Canada

Any distribution of the Offer Share in Canada will be made only in the provinces of Ontario and Quebec, by an investment dealer, an exempt market dealer or a restricted dealer, in each case, that is registered in accordance with applicable provincial securities laws, or by a person that is exempt from registration under such laws under the "international dealer registration exemption" in Section 8.18 of National Instrument 31-103, and for greater certainty, will be undertaken in accordance with applicable provincial securities laws so that the Company does not become subject to such laws as a "reporting issuer".

17.6 Dubai International Financial Centre ("DIFC")

This Prospectus relates to an Exempt Offer in accordance with the Offered Securities Rules of the Dubai Financial Services Authority ("**DFSA**"). This Prospectus is intended for distribution only to persons of a type specified in the Offered Securities Rules of the DFSA. It must not be delivered to, or relied on by, any other person. The DFSA has no responsibility for reviewing or verifying any documents in connection with Exempt Offers. The DFSA has not approved this Prospectus nor taken steps to verify the information set forth herein and has no responsibility for the Prospectus. The Ordinary Shares to which this Prospectus relates may be illiquid and/or subject to restrictions on their resale. Prospective purchasers of the Ordinary Shares offered should conduct their own due diligence on the Ordinary Shares. If you do not understand the contents of this Prospectus you should consult an authorised finance advisor.

In relation to its use in the DIFC, this Prospectus is strictly private and confidential and is being distributed to a limited number of investors and must not be provided to any person other than the original recipient, and may not be reproduced or used for any other purpose. The interests in the Ordinary Shares may not be offered or sold directly or indirectly to the public in the DIFC.

17.7 Switzerland

The Ordinary Shares may not be publicly offered in Switzerland and will not be listed on the SIX Swiss Exchange ("**SIX**") or on any other stock exchange or regulated trading facility in Switzerland. This document has been prepared without regard to the disclosure standards for issuance prospectuses under art. 652a or art. 1156 of the Swiss Code of Obligations or the disclosure standards for listing prospectuses under art.27 ff. of the SIX Listing Rules or the listing rules of any other stock exchange or regulated trading facility in Switzerland. Neither this document nor any other offering or marketing material relating the Ordinary Shares or the Offer may be publicly distributed or otherwise made publicly available in Switzerland.

Neither this document nor any other offering or marketing material relating to the Offer, the Company, or the Ordinary Shares have been or will be filed with, and the offer of Ordinary Shares will not be supervised by, the Swiss Finance Market Supervisory Authority FINMA ("**FINMA**"), and the offer of Ordinary Shares has not been and will not be authorised under the Swiss Federal Act on collective investment schemes under the CISA does not extend to acquirers of Ordinary Shares.

17.8 Jersey

There shall be no circulation in Jersey of any offer for subscription, sale or exchange of the Ordinary Shares unless (a) such offer does not for the purposes of Article 8 of the Control of Borrowing (Jersey) Order 1958, as amended, constitute an offer to the public; or (b) an identical offer is for the time being circulated in the United Kingdom without contravening the Financial Services and Markets Act 2000 and is, *mutatis mutandis*, circulated in Jersey only to persons similar to those to whom, and in a manner similar to that in which, it is for the time being circulated in the United Kingdom.

17.9 Guernsey

To the extent to which any promotion of the Ordinary Shares is deemed to take place in Guernsey, the Ordinary Shares are only being promoted in or from within the Bailiwick of Guernsey either (i) by persons licensed to do so under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 (as amended) or (ii) to persons licensed under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 (as amended), the Insurance Business (Bailiwick of Guernsey) Law, 2002 (as amended), the Banking Supervision (Bailiwick of Guernsey) Law, 1994 (as amended) or the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000 (as amended). Promotion is not being made in any other way.

PART VII—INFORMATION ON THE COMPANY AND THE GROUP

The Company was incorporated on 26 July 1988 as a private limited company with registered number 02280426. On 3 February 2012, the Company re-registered as a public limited company and changed its name from RBS Insurance Group Limited to Direct Line Insurance Group plc. The Company operates under the Companies Act 2006. The registered office of the Company is at Churchill Court, Westmoreland Road, Bromley BR1 1DP, United Kingdom and its telephone number is +44 (0) 208 313 5810.

DESCRIPTION OF THE BUSINESS OF THE COMPANY AND THE GROUP

OVERVIEW

Direct Line Group is a retail general insurer with leading market positions in the United Kingdom, a strong presence in the direct motor channel in Italy and Germany and a focused position in UK SME Commercial. The Group utilises a multi-brand, multi-product and multi-distribution channel business model that covers most major customer segments in the United Kingdom for personal lines general insurance and a more limited presence in the commercial market. The Group occupies leading market positions in terms of in-force policies and has the most highly recognised brands in the United Kingdom for personal motor insurance and personal home insurance.

The Group's business is comprised of the following five reportable segments:

- ***Motor:*** With 27 years of experience in motor insurance, the Group is the leading personal motor insurer in the United Kingdom in terms of in-force policies, with approximately 4.1 million in-force policies as at 31 December 2011 and 4.2 million in-force policies as at 30 June 2012 and a market share of 19% as at 31 December 2011 (source: Motor & Home market share data © GfK NOP Financial Research Survey (FRS) 3 months ending Dec 2011, 6,901 adults interviewed for Motor and 7,234 for Home). In addition to core motor insurance cover of third-party liability, fire and theft, accidental damage, and protection for no-claims discount, the Group offers insurance cover that includes motor legal protection and guaranteed hire car. The Group sells motor insurance in the United Kingdom through its own brands—Direct Line, Churchill, and Privilege—and through distribution partnerships with a number of household names, including Prudential, RBS/NatWest, Sainsbury's, Peugeot and Citroen. The Group's brand and product offering covers most major retail customer segments for motor insurance in the United Kingdom. For the six months ended 30 June 2012 gross written premiums for the Group's motor insurance business were £842.1 million, representing 40.9% of total ongoing gross written premiums for the Group, and for the year ended 31 December 2011, gross written premiums for the Group's motor insurance business were £1,734.8 million, representing 42.1% of total ongoing gross written premiums for the Group.
- ***Home:*** The Group is also the leading personal home insurer in the United Kingdom in terms of in-force policies, with approximately 4.3 million in-force policies as at 31 December 2011 and 4.3 million in-force policies as at 30 June 2012 and a market share of 18% as at 31 December 2011 (source: Motor & Home market share data © GfK NOP Financial Research Survey (FRS) 3 months ending Dec 2011, 6,901 adults interviewed for Motor and 7,234 for Home). In addition to core home insurance cover of buildings, contents, accidental damage and personal possessions, the Group offers insurance cover that includes family legal protection and home emergency. The Group sells home insurance in the United Kingdom through its own brands—Direct Line, Churchill, and Privilege—and through distribution partnerships with a range of well-known brands, including RBS/NatWest, Nationwide, Sainsbury's and Prudential. As with the Group's motor insurance business, the Group's brand and product offering covers most major retail customer segments for home insurance in the United Kingdom. For the six months ended 30 June 2012 gross written premiums for the Group's home insurance business were £484.4 million, representing 23.5% of total ongoing gross written premiums for the Group and for the year ended 31 December 2011, gross written premiums for the Group's home insurance business were £1,031.3 million, representing 25.0% of total ongoing gross written premiums for the Group.
- ***Rescue and Other Personal Lines:*** The Group's rescue and other personal lines business in the United Kingdom includes rescue and recovery insurance products as well as travel and pet insurance, with approximately 9.2 million in-force policies as at 31 December 2011 and 9.7 million in-force policies as at 30 June 2012. Green Flag, the Group's rescue and recovery brand, operates the United Kingdom's third largest roadside rescue and recovery service in terms of members with an

estimated market share of 16.3% for 2011 (source: Mintel Study 2011, excludes multiple personal third-party and manufacturer memberships). DLG sells its other personal lines insurance through the Direct Line, Churchill and Privilege brands, and through its distribution partnerships, including those with Prudential, RBS/NatWest and Nationwide. For the six months ended 30 June 2012 gross written premiums for the Group's rescue and other personal lines business were £199.3 million, representing 9.7% of total ongoing gross written premiums for the Group and for the year ended 31 December 2011, gross written premiums for the Group's rescue and other personal lines business were £350.2 million, representing 8.5% of total ongoing gross written premiums for the Group.

- ***Commercial:*** The Group provides commercial insurance predominantly for micro businesses and small and medium-sized enterprises ("**SMEs**") in the United Kingdom, with approximately 0.4 million in-force policies as at 31 December 2011 and 0.5 million in-force policies as at 30 June 2012 and an estimated market share of 9% within the micro business and SME market as at 31 December 2011. The Group's commercial products include commercial property, business interruption, general liability, personal accident and commercial motor insurance, and are sold through its own brands—NIG and DL4B—and through its distribution partnerships with RBS/NatWest. For the six months ended 30 June 2012 gross written premiums for the Group's commercial insurance business were £229.8 million, representing 11.2% of total ongoing gross written premiums for the Group and for the year ended 31 December 2011, gross written premiums for the Group's commercial insurance business were £438.6 million, representing 10.6% of total ongoing gross written premiums for the Group.
- ***International:*** In addition to its UK business, the Group sells motor insurance in Germany and Italy primarily through its Direct Line brand. The Group sells its motor insurance to private customers in Germany and Italy (which represent the two largest motor vehicle markets in Europe) using a multi-channel strategy similar to that used in the United Kingdom, with approximately 1.4 million in-force policies as at both 31 December 2011 and 30 June 2012, and a market share of 31% within the Italian direct motor market and 12% within the German direct motor market in 2011 (source: ANIA Italiana Report; GDV Direct Market Study 2011, respectively). The Group's international insurance business has grown in terms of gross written premiums at a compound annual growth rate ("**CAGR**") of 26.9% from 2009 to 2011. For the six months ended 30 June 2012 gross written premiums for the Group's international insurance business were £302.8 million, representing 14.7% of total ongoing gross written premiums for the Group and for the year ended 31 December 2011, gross written premiums for the Group's international insurance business were £570.0 million, representing 13.8% of total ongoing gross written premiums for the Group.

Beginning in late 2009, the Group initiated the first stages of its transformation plan encompassing a range of initiatives aimed at improving profitability and better leveraging the competitive advantages it holds through its brands and large scale. The key aspects of those initiatives included significantly enhancing the Group's pricing and claims capabilities, discontinuing certain unprofitable business lines, rationalising its operations, focusing on efficiency improvements and reducing costs, and significantly increasing its technical reserves relating to prior year claims. See "*—History of the Business—Development of the Group*". The Group continues to rebuild its competitive advantage, implementing strategic initiatives with key specific targets in return on tangible equity, core operating ratio and gross costs savings (see "*—Strategy*"), with an overall objective of delivering a business targeting shareholder returns.

KEY STRENGTHS

The Group utilises a multi-brand, multi-product and multi-distribution channel business model. The Group positions each of its brands to offer a superior proposition to distinct customer segments. When combined effectively with its significant scale, the Group believes this allows it to target superior performance in distribution, pricing, claims and operational efficiency, which in turn should position the Group to deliver value to customers and sustainable returns.

The Board believes that the Group has a number of key business strengths, as set out below:

Leading UK retail general insurance franchise with market leading brands and significant scale

The Group is the leading personal motor insurer in the United Kingdom in terms of in-force policies with a market share of 19% and the leading home insurer in the United Kingdom in terms of in-force policies with a market share of 18%, in each case as at 31 December 2011 (source: Motor & Home market share data © GfK NOP Financial Research Survey (FRS) 3 months ending Dec 2011, 6,901 adults interviewed for

Motor and 7,234 for Home). Over 45% of households in the UK obtained a direct quote from the Group over the past three years, excluding existing customers and quotes on PCWs. The Group's two core brands, Direct Line and Churchill, have been major contributors to the Group's success. Direct Line and Churchill enjoy the highest levels of recognition in both the UK personal motor and home insurance markets (source: Nunwood Brand Tracking Motor and Home prompted awareness January 2011-December 2011) and support strong customer retention rates. In 2011, the motor retention rates for Direct Line and Churchill were 78% and 76% respectively, compared with 70% for the UK motor insurance market generally (source: Retention rates GfK NOP Financial Research Survey (FRS) 6 months ending December 2011, 1,379 adults interviewed for Direct Line and 829 adults interviewed for Churchill. The Group also benefits from a long history as a large insurer, evidenced by over 100 million cumulative motor vehicle years of experience writing motor insurance. The Group also has a number of strategic partnerships with other leading brands such as Nationwide, Prudential, RBS/NatWest and Sainsbury's, which further enhance customer access. The Board believes this, together with the Group's scale should allow competitive advantages to be built in pricing and reserving and provides the Group with the opportunity to leverage its brands and experience across the range of its products, and to benefit from its purchasing power and other economies of scale.

Multi-channel distribution model allows brand deployment across distinct customer segments

The Group employs a multi-channel model to distribute its insurance products, and looks to optimise the mix of these channels for each of its products and brands. The channels used by the Group include direct to consumer sales (over the phone and via the internet), PCWs (where it recently launched certain of the Group's motor products on comparethemarket.com, the UK's largest PCW), and the branches of its partners. Its commercial business also uses broker channels. By tailoring the distribution channel mix for each product, the Group can target its own powerful brands and those of its partners across distinct customer segments, seeking to offer its customers a combination of brands, channels, product features, prices and services that best addresses their needs. The Group's multi-channel distribution model should also enable it to adapt quickly to changes in customer behaviour and new market trends. The Group derives extensive pricing and claims data from those customers, which enhances the quality and quantity of data that can be used in the Group's pricing models and so help improve the accuracy of its technical pricing and understanding of emerging market trends, helps develop a deeper understanding of its distinct customer segments, and, in turn, assists the Group in its aim of generating superior operating performance.

Strong, direct customer relationships with the Group's brands drive customer lifetime value and provide cross-selling opportunities for extensive product offering

The Group sells a substantial majority of its motor and home policies through direct to customer sales channels, including over the phone and on the internet. These customer sales channels provide an opportunity for the Group to develop ongoing and direct relationships with its customers, allowing the Group to follow its customers' needs and helping it to attract more customers from the most valuable customer segments, thereby helping it to increase persistency and enhance customer lifetime value. Direct customer relationships also allow the Group to leverage its extensive range of insurance products (such as rescue, pet and travel products) to enhance cross-selling opportunities and satisfy more customers with a wider range of products. As at December 2011, 53% of Direct Line home insurance customers and 37% of Churchill home insurance customers also had motor insurance with those brands, against a market average of 23% (source: Cross product holdings GfK NOP Financial Research Survey (FRS) 12 months ending December 2011, 1,219 adults interviewed for Direct Line and 750 adults interviewed for Churchill).

New management team returned the Group to profit in 2011

The depth of individual experience on the management team is enhanced by the breadth of complementary experience of the team overall. Members of this team have driven the transformation plan for the Group, the implementation of which began in late 2009 when the Group initiated significant changes to its pricing model, particularly for the Group's motor insurance business, designed to reduce overall exposure to higher-risk policyholders (such as young drivers), re-pricing of premium more generally, and discontinuing certain unprofitable business lines such as personal lines business sold via brokers, certain fleet and taxi business, and its motorcycle business. The team has also focused on the Group's ongoing cost base by reducing the number of operations centres, both in its personal lines and commercial lines business, from 34 at the beginning of 2010 to 18 at 30 June 2012, reducing its cost of claims, and improving efficiency within its sales and service functions. In addition, the Group significantly

increased its technical reserves relating to motor bodily injury in 2009 and 2010. The Board believes that a key indicator of the management team's success was demonstrated by the improvement in the combined operating ratio from ongoing operations from 121% for the year ended 31 December 2010 to 101% for the six months ended 30 June 2012. In the six months ended 30 June 2012, the Group generated operating profit from ongoing operations of £224.2 million and benefitted from a further improvement in claims performance with a loss ratio from ongoing operations of 67.3% compared with 74.2% in the six months ended 30 June 2011.

Since 2011, the management team has overseen the separation of the Group's operations from the RBS Group, including the development of new governance and HR functions, as well as a new corporate identity, while maintaining high employee engagement. Based on an independent review, the Group's levels of employee engagement in 2011 were higher across a number of factors than UK insurance industry peers generally, and also above other global companies undergoing significant transitional change (source: Towers Watson 2011 Survey). The management team continues to focus on rebuilding the Group's competitive advantage through various further initiatives (see "—*Strategy*").

Robust balance sheet and conservative investment strategy

The Group maintains a level of capitalisation commensurate with its risk appetite, and manages its balance sheet in accordance with regulatory, rating agency and risk based economic capital metrics. The Group seeks to hold capital resources in the range of 125-150% of risk-based capital, and at 30 June 2012, the risk-based capital coverage ratio was 160.0%. The Group's estimated reserve margin above Towers Watson's independent actuarial best estimate at 30 June 2012 was 7.1%. The Group had an IGD surplus of £2.2 billion, and an estimated IGD coverage ratio of approximately 306% at 30 June 2012, see "—*Capital Resources—Capital management policy*". U K Insurance, the Group's principal operating entity is currently rated "A" with a stable outlook by Standard & Poor's (a credit rating agency registered in the EU) and "A2" with a stable outlook by Moody's (a credit rating agency registered in the EU).

The Group has undertaken several initiatives reflecting the Board's approach to efficient management of capital resources, including the rationalisation of its UK general insurance legal entity structure in 2011. During the six month period ending 30 June 2012, the Group took a number of steps to create a more efficient capital structure (in a manner consistent with the Group's risk appetite) principally by reducing the Group's weighted average cost of capital through returning surplus capital to shareholders and replacing higher cost equity with cheaper debt financing. Actions to effect this included returning surplus capital through the payment of £1 billion dividends to the Selling Shareholder since 1 January 2012 and the introduction of external debt leverage through the raising of £500 million of tier 2 subordinated debt in April 2012.

The Group has pursued a conservative investment strategy focused on liquid and strongly rated investment grade fixed income securities, primarily corporate and sovereign bonds with an "A" rating or better from a ratings provider within either the Standard & Poor's or Moody's group. As at 30 June 2012, 100% of the Group's investment portfolio was invested in fixed income securities and cash, with 69.8% of the portfolio invested in debt securities (comprising government bonds, corporate bonds and mortgage-backed securities). At 30 June 2012, approximately 93% of the debt securities were held in "A" rated or better assets, with an overall duration of 2.4 years.

STRATEGY

The Board's intention is to build on its transformation plan and unlock the value in the UK's leading retail general insurance franchise and to deliver shareholder returns, targeting a 15% return on tangible equity. While the initial priorities of the Group's transformation plan were the strengthening of the management team, the implementation of certain pricing, claims, cost and capital initiatives (see "—*Key Strengths*"), the Board believes the Group's key strengths provide significant opportunities to leverage its existing scale to improve the sophistication of its approach to distribution, pricing, and claims, and enhance operating and capital efficiency with the aim of delivering sustainable competitive advantage. The Board believes that the successful implementation of the key strategic initiatives discussed below should enable the Group to achieve a 15% return on tangible equity, and the Group is specifically targeting a combined operating ratio for the ongoing business of 98% by 2013, with a target combined operating ratio for the Group's commercial insurance business below 100% by 2014, accompanied by gross annual cost and claims handling savings of £100 million by the end of 2014. The Board intends to achieve these objectives while retaining capital levels consistent with a credit rating in the "A" range.

Key strategic initiatives for the Group are the following:

Distribution—enhance effectiveness to improve customer lifetime value: As the Group continues to focus on developing products and services designed to meet the varying needs of its customers and expands the penetration of these products through PCWs and the Group's distribution partnerships, it will seek to improve the efficiency with which it attracts, retains and services its customers. The Group seeks to utilise its customer segmentation insights to improve acquisition targeting and better align its marketing spend and mix across brands, channels, and customer segments. The Group also seeks to leverage new technologies including mobile, email and tablet communications and social media to distribute its products and engage more directly with customers, driving brand awareness among the Group's target customers. Each of these initiatives will be aimed at increasing customer lifetime value and developing long-term customer relationships. The Group will also seek to realise greater value by better exploiting the opportunities it has to cross-sell its products to its extensive customer base.

Pricing—build superior pricing capabilities to utilise scale advantage in data: The Group is improving its internal and external data collection, analysis and application of this data, and utilisation of the significant volume of its existing and historical data. Through significant enhancements to its pricing models and systems, the Group is seeking to achieve industry-leading technical pricing models and the deployments of same-day rate and algorithm changes. The Group believes these improvements should help it enhance its underwriting and risk selection, price its products more accurately, attract fewer but better quotes with a higher conversion rate, and respond quickly and efficiently to market changes. These enhancements include multi-dimensional pricing models, which the Group intends to improve further with a view to enabling a more refined level of pricing to be achieved based on available data. Assuming the current insurance climate continues, the Group believes that, over the medium term, its significant scale, when combined with increased sophistication in pricing and underwriting, will help improve its risk management and help generate higher returns within the business.

Claims—attain market leading position in claims management: The Group launched a new claims system in 2011 and expects to bring all new UK personal lines claims onto one common system by the end of 2013. The new common claims system will promote increased analytical capabilities as well as enhanced operational control, including areas such as records management. All new motor claims for the Group's own brands (not including commercial motor claims) have been processed on the system since November 2011. The Group believes the new system, coupled with a range of other initiatives such as increased detection of fraud and more efficient supply chain management, should result in increased benefits from more proactive claims management, including third-party bodily injury claims. The Group subjects major strategic claims initiatives to statistically-based pilot testing before fully rolling out across operations, with a view to ensuring those initiatives achieve the desired benefits and are appropriate operational processes, and has observed significant benefits in recent bodily injury and fraud pilots. All new home claims are scheduled to be processed on the Group's new claims system by the end of 2012 with commercial claims following in 2014.

Operational efficiency—realise the significant cost opportunity: The Group's management team has already demonstrated its significant resolve to improve the operating efficiency of the Group, beginning a site rationalisation programme in 2010 and exiting 16 operating sites by 30 June 2012. It aims to exit up to a further 3 sites by the end of 2012 and to reduce the number of operating sites to 13 by 2014. The team has also focused on streamlining the Group's organisational structure and controlling staff costs, reducing full time employees ("**FTEs**") by 9% from 2009 to 2011. The Group will focus on further reducing operational costs, targeting the delivery of gross annual cost and claims handling savings of £100 million by the end of 2014, through overall improvements in operational efficiency, continued efforts to simplify its internal organisational structure, optimising procurement, off-shoring certain functions, and better managing its customer acquisitions costs. The first phase of the proposed initiatives includes: reducing costs and improving efficiency in the Group's sales, service and partnerships division, which has resulted in the proposed closure of the Group's site in Teesside, reducing costs in the Group's commercial insurance business' head office, and a reorganisation of IT application development and business testing functions in the Group's chief operating office. The Group will continue to evaluate its operations with the aim of taking what the Board believes is a clear opportunity to reduce cost and bureaucracy. The Group currently estimates that the one-off cost of implementing those annual cost savings are expected to be in the region of £100 million, substantially all of which is expected to be incurred in 2013.

Commercial and International—leverage core skills to improve performance: The Group believes the UK commercial insurance market for SMEs and micro-businesses has been trending toward broker e-trading and direct distribution, and this should allow the Group to leverage its strengths in personal lines to build its commercial business. DL4B, the Group's direct commercial brand, has grown strongly in recent years and now represents 18% of the gross written premiums of the Group's commercial insurance business. The Group currently intends to focus on broker e-trading and direct distribution in the micro business and SME markets, with the first e-trade product launch occurring in September 2012 and the next product launch expected to take place from November 2012 through February 2013. At the same time, the Group intends to reduce the costs and the complexity of its traditional broker business. Through this shift in distribution mix and strategic exiting of certain poor performing businesses, the Group is targeting a combined operating ratio of less than 100.0% for the Group's commercial insurance business by 2014.

The Group's international business has built leading market positions among direct insurers in Italy and Germany, with local management experience complementing core Group strengths. The Group intends to build on local talent in its international insurance business while leveraging the improving UK pricing and claims systems and expertise to drive operational efficiencies. Specific initiatives aimed at improving efficiency in the Group's international insurance business include improved claims management, a simplified and web-based customer contact centre, and faster time to market on pricing and sales. The Group believes it has achieved sufficient scale in its Italian business to focus on seeking profit growth through targeted customer segmentation and cost saving initiatives. It will seek to accelerate growth in its German business through PCWs and new distribution partnerships.

HISTORY OF THE BUSINESS

Development of the Group

Direct Line was launched in 1985 in partnership with the RBS Group and was subsequently wholly-acquired by the RBS Group in 1988. The Group's aim was to bring new standards of service and simplicity to the private motor insurance industry by dealing directly with the customer over the telephone. Direct Line was able to "cut out the middle man" and offer a faster, more efficient and convenient service. In 1990, Direct Line used the red telephone on wheels for the first time in television commercials, and the symbol has since become synonymous with the Direct Line brand. In 1999, Direct Line began to operate through the internet channel and quickly grew to become a leading UK internet general insurance provider. In addition to motor, Direct Line began to offer home insurance in late 1988, with pet and travel products being introduced in 1997.

In 1998, the Group began expanding its portfolio of UK insurance brands, purchasing Privilege Insurance Company Limited ("**Privilege**"). In 1999, the Group acquired Green Flag Holdings Limited ("**Green Flag**"), the holding company for the Green Flag motoring assistance network, and began offering motor rescue and emergency breakdown cover. U K Insurance, which is now the Group's principal UK statutory general underwriting entity, was a subsidiary of Green Flag.

Also in 1999, the RBS Group launched Tesco Personal Finance Limited ("**TPF**"), a 50:50 joint venture with Tesco plc ("**Tesco**"). As part of this relationship, the Group underwrote a range of general retail and life insurance products under the Tesco brand. The RBS Group sold its share in TPF to Tesco in July 2008, but the Group has ongoing arrangements in relation to TPF which are described in "*Run-off Businesses*" below.

The Group began its international expansion in 1995 through the creation of Linea Directa, a direct motor insurance joint venture with Bankinter in Spain. Following the change in control of the RBS Group in 2008, when HM Treasury became the majority shareholder in RBS Group plc, Bankinter exercised an option in 2009 under the Linea Directa joint venture agreement to buy out the RBS Group's 50% stake in the Spanish business. In 2001, the Group acquired the European motor insurance businesses of Allstate Corp, which had operations in Germany and Italy, and in 2002, it acquired the business of Royal Insurance from R&SA Assicurazioni. These German and Italian businesses were rebranded as Direct Line and gave the Group a footprint in Europe's two largest motor vehicle markets.

During the period culminating in the acquisition of Churchill Insurance Group PLC in 2003, the Group experienced rapid growth in gross written premiums for its motor business, with its core operating ratio outperforming the overall UK motor market. The Group acquired Churchill Insurance Group PLC, which included the general insurance companies, Churchill Insurance Company Limited (together, "**Churchill**") and The National Insurance and Guarantee Corporation Limited ("**NIG**"), from Credit Suisse Group.

This acquisition enhanced the Group's distribution and product capabilities by adding a number of key long term partnership distribution agreements, including with Nationwide, as well as broker arrangements and commercial insurance through NIG. Together with Direct Line and Privilege, the acquisition of Churchill substantially increased the Group's customer base and established the Group's current UK brand portfolio, allowing it to offer personal motor, home and other insurance through multiple channels to most major UK customer segments.

Through the late 1990s and 2000s, industry-wide changes in credit hire, an increase in bodily injury claims driven by increased penetration of claims management companies, an increase in no-win/no-fee arrangements, and increases in PPOs substantially increased the demands on the Group's operating models and systems including complex and geographically fragmented UK claims management processes. The combination of these events had a negative impact on Group trading and resulted in a period of financial underperformance for the Group, with operating losses of £79.5 million and £375.4 million incurred in the years ended 31 December 2009 and 2010, respectively. At the end of 2009, the Group initiated a transformation plan encompassing a range of initiatives to address the underperformance. The key aspects of those initiatives included significantly enhancing the Group's pricing capabilities (particularly for motor insurance, including reducing overall exposure to higher risk policyholders such as young drivers), discontinuing certain unprofitable business lines such as fleet and taxi business, selling its motorcycle business as well as working to reduce the number of operations centres, both in its personal lines and commercial lines business, from 34 at the beginning of 2010 to 19 at the end of 2011. In addition, in 2009 and 2010, the Group significantly increased its technical reserves relating to motor bodily injury. In 2010, the Group withdrew from its NIG personal lines business sold via brokers and in 2011, the Group ceased writing new life business in its Direct Line life insurance business.

Having taken these steps, the Group continues to target rebuilding its competitive advantage and create a more efficient capital structure and has undertaken several initiatives with respect to pricing, claims, cost efficiency, risk and capital management and employee development. For example, in December 2011, the Group completed the reorganisation of its UK statutory general underwriting entities into common ownership under one entity, U K Insurance, which now conducts all underwriting activities for the Group's UK business. This was done to streamline internal operations in anticipation of the new EU Solvency II regulations. As part of the separation process from the RBS Group, the Group also acquired ownership of Direct Line Versicherung AG. While the German operations of the Group had been managed as if part of the Group, and have been combined in the Group's Historical Financial Information, the legal entity in which these operations sit was not a direct or indirect subsidiary of the Company until 2 April 2012. For a full description of the Group's strategic plan, see "*—Strategy*" above.

SEPARATION FROM THE RBS GROUP

As described in Part VI: "*Details of the Offer—Reasons for the Offer and Admission*", in 2009, the RBS Group committed to the European Commission and HM Treasury to sell its insurance business as a condition of its receipt of State Aid. To comply with this requirement, the RBS Group must cede control of the Group by the end of 2013 and must have divested its entire interest by the end of 2014. In preparation for the Offer, the Group and the RBS Group have undertaken a number of steps to separate their businesses and establish an arm's-length relationship. The key elements of this separation are described below.

Retail Distribution Agreement and Commercial Distribution Agreement with RBS/NatWest

On 21 September 2012, the Group renewed and expanded its distribution partnership with RBS/NatWest on arm's length terms for a five year period to offer insurance alongside bank accounts, including travel insurance, as well as home, motor and commercial insurance. The changes resulting from the new arrangements are not believed by the Board to be material in the context of the Group's business as a whole. See Part XVI: "*Additional Information—Related Party Transactions—15.1 and 15.2*" for a summary of the terms of these new arrangements. The RBS/NatWest partnership is a significant contributor to the Group's total gross written premiums within its home segment (19.5% of the Group's GWP in 2011). In total RBS/NatWest brand products represented 8.7% of ongoing gross written premiums in the six months ended 30 June 2012 and 8.9%, 8.5% and 7.5% of ongoing gross written premiums in the years ended 31 December 2011, 2010 and 2009, respectively. See Part XVI: "*Additional Information—Related Party Transactions*".

German business

While the German operations of the Group are (and have been) managed as if part of the Group, the legal entity in which these operations reside was not a direct or indirect subsidiary of the Issuer until 2 April 2012, when the ownership of Direct Line Versicherung AG was transferred from the RBS Group to the Issuer for €145.0 million. A summary of the sale and purchase agreement is described in Part XVI: "*Additional Information—Material Contracts—The DLVA Acquisition Agreement*".

Operations and systems separation

In early 2011 the Group commenced a major project to separate its operations from the RBS Group. The project encompassed the transfer, replacement or replication of the essential assets, services, processes and governance, previously provided by the RBS Group. Customer facing operations have always been largely separate from the RBS Group. Therefore, the principal separation requirements involved head office and control functions, including finance, risk, human resources, company secretariat, legal, internal audit, corporate communications, property and logistics, and purchasing functions. IT infrastructure and certain other limited services will continue to be provided by the RBS Group under the TSA until a date specified in the TSA, being in the first instance, no later than 36 months after Admission. The Group does have a right to extend the service term until completion of migration subject to payment of additional charges. See Part XVI: "*Additional Information—Material Contracts—Transitional Services Agreement*".

Other separation actions

In addition to the actions taken by the Group with respect to operations and systems separation, there are various specific reorganisation arrangements that have been implemented between the RBS Group and the Group during 2012, the most significant ones of which are:

- ***Property leases and asset transfer:*** The Group has assumed from the RBS Group the ongoing lease obligations in relation to certain properties that were occupied by the Group but were in the name of the RBS Group. The Group also agreed to compensate the RBS Group for ongoing lease obligations in relation to certain properties that have been vacated by the Group as part of the site rationalisation programme. Certain fixed assets, comprising of furniture, fixtures, fittings and technology relating to these properties were also transferred to the Group by the RBS Group for a consideration of £43.1 million during 2012. The Group also sold a number of freehold investment properties to RBS Group for a consideration of £69.5 million in June 2012.
- ***Pensions:*** DL Insurance Services Limited ("**DLISL**") (a wholly owned subsidiary of the Company) previously participated in the RBS defined benefit pension scheme known as the "**RBS Group Pension Fund**". It ceased doing so on 31 May 2012, after consulting with employees who were accruing benefits under the RBS Group Pension Fund. The DLISL employees who have left the RBS Group Pension Fund are eligible to join the new Group personal pension plan established by DLISL.

  On 29 June 2012, DLISL entered into an arrangement with RBS plc, National Westminster Bank plc and the trustee of the RBS Group Pension Fund to settle the debt owed to the trustee of the RBS Group Pension Fund by DLISL on its withdrawal from the scheme, and to obtain a discharge from any further liability under the rules of the RBS Group Pension Fund and the scheme funding and employer debt legislation. Under the terms of this arrangement (a flexible apportionment arrangement), DLISL paid £31.3 million to the trustee of the RBS Group Pension Fund which was the debt that had arisen in relation to the benefits that had accrued to DLISL's own current and former employees. All remaining liabilities of DLISL in relation to the scheme were assumed equally by RBS plc and National Westminster Bank plc as continuing employers in the RBS Group Pension Fund.

As a result of these divestment and other separation actions, the Group incurred restructuring and one-off costs of £108.7 million during the six months ended 30 June 2012. The Group currently estimates additional divestment and other separation costs of in the region of £60 million for the second half of 2012, before any applicable tax deduction. This does not include the £100 million costs relating to migration of the Group's IT services referred to in "*—IT migration*" below or any costs incurred in connection with the Group's administrative cost reduction initiatives referred to in "*—Strategy—Operational efficiency—realise the significant cost opportunity*".

IT migration

The Group will continue for a period of time to rely on the RBS Group for significant IT services, including IT infrastructure and certain other non-IT services. These services are provided for under the TSA between the Group and the RBS Group (see Part XVI: "*Additional Information—Material Contracts—Transitional Services Agreement*"). The Group is not dependent on any RBS Group core applications, as the Group's main applications are developed and owned by the Group itself. In connection with the migration of the IT services to the Group during and at the end of the TSA period, the Group will be making a significant investment in its own IT to prepare for and execute that migration, and expects to incur one-off costs in the region of £100 million, before any applicable tax deduction, in roughly similar amounts over 2013 and 2014. This amount does not include the operating costs to be incurred under the TSA, which are currently incurred by the Group under the re-charge arrangements with RBS Group (see "*—Information Technology*" as well as Part II: "*Risk Factors—Risks relating to the Group—The Group's operations support complex transactions and are highly dependent on the proper functioning of information technology and communication systems*" and "*Risk Factors—Risks relating to the Group—The Group will rely on a transitional service agreement with the RBS Group, particularly with respect to IT services*"). Following migration and the end of the TSA period, the Group currently expects ongoing run-rate costs for IT infrastructure services to be broadly in line with annual TSA expenditures.

BRANDS AND CUSTOMERS

The Group sells insurance through a multi-brand, multi-channel platform, allowing it to tailor marketing and distribution of its products across different market and customer segments. The Board believe this strategy provides an opportunity for the Group to offer a distinct customer proposition with each of its brands, optimising distribution to attract a diverse base of customers while facilitating deeper customer relationships and higher rates of customer retention.

The Group sells insurance through a range of its own brands and several partnership brands through its distribution arrangements. The following table provides a high level summary of the different general insurance products sold within each of the Group's own brands and principal partner brands:

Brand	Motor	Home[1]	Rescue and other PL[2]	Commercial	International
Own brands					
Direct Line	✓	✓	✓	✓	✓
Churchill	✓	✓	✓		
Privilege	✓	✓	✓		
Green Flag			✓		
NIG				✓	
DL4B				✓	
Principal partner brands					
Prudential	✓	✓	✓		
RBS/NatWest	✓	✓	✓	✓	
Nationwide		✓	✓		
Sainsbury's	✓	✓			

(1) Includes home and home emergency insurance

(2) Includes rescue, pet, and travel insurance

Customers

The Group's multi-brand, multi-channel platform is designed to appeal to different segments of the customer market. Different customers have different attitudes and behaviour, and the Group seeks to understand its customers better through a segmented approach to the marketing and distribution of its products. Based on a survey of 5,000 UK consumers, the Group developed a proprietary customer segmentation model around core customer characteristics, attitudes and behaviours, including price sensitivity, brand affiliation, need for support and advice, and level of time invested in obtaining insurance. By analysing the relative weighting of these factors among customers, the Group has constructed its marketing and distribution model around eight distinct customer segments, each with its own needs and behaviours.

The Group uses this eight segment customer model to help position its own brands to attract, capture and retain customers, which the Group believes will have a greater potential to deliver long term value. By leveraging a consumer database with approximately 49 million customer records, the Group seeks to better understand the needs and behaviours of customers within those eight segments and target its customer acquisition efforts at those segments that deliver higher customer lifetime value. As a result of these targeted efforts, the Group estimates that what it considers to be the four most valuable customer segments account for approximately 70% of the Group's existing home and motor insurance books (i.e. the number of in-force policies for the segments). Together with partnering with other well-known brands, the Group believes it can develop deeper relationships with its customers, allowing it to cross-sell products, retain customers at rates above the UK market average and generate good returns.

Own brands

The core own brands of Direct Line, Churchill and Privilege together accounted for 72% of gross written premiums for the Group's UK personal lines business in the year ended 31 December 2011 and 72% in the six months ended 30 June 2012, and substantially all gross written premiums within the Group's motor business.

The Group markets its Direct Line brand directly to consumers through channels including telephone and the internet; Direct Line is not available through PCWs in the United Kingdom. The Group's Direct Line brand targets customers who the Group believes have a lower need for support and advice but high brand affinity, focusing on a quick and simple customer experience. In 2011, 71% of motor consumers named Direct Line as a brand they would consider buying, above the tracked market average (source: Nunwood Brand Tracking Survey). Implementation of the Direct Line brand strategy requires a significant amount of marketing, and as a result Direct Line accounts for 66.9% of total Group advertising spending on its core own brands. Direct Line offers the full range of Group products and is the primary brand through which Group products are offered in Italy and Germany (including through PCWs). Direct Line is one of the UK's market leading brands and has a motor customer retention rate of 78% and a cross-product holding rate among Great Britain home and motor insurance customers of 53% (sources: Retention rates GfK NOP Financial Research Survey (FRS) 6 months ending December 2011, 1,379 adults interviewed; Cross product holdings GfK NOP Financial Research Survey (FRS) 12 months ending December 2011, 1,219 adults interviewed).

The Group markets its Churchill brand directly to consumers in the United Kingdom through various channels including telephone and the internet, as well as through PCWs. The Group's Churchill brand targets customers who the Group believes have a higher need for support and advice and high brand affinity, focusing on a reassuring and supportive customer experience. In 2011, 72% of motor consumers named Churchill as a brand they would consider buying, above the tracked market average (source: Nunwood Brand Tracking Survey). Churchill accounts for 32.6% of total Group advertising spending on its core own brands. Churchill offers most of the Group's products in the United Kingdom to individuals and enjoys a customer retention rate among the Great Britain motor insurance market of 76% and a rate of cross-product holdings among Great Britain home and motor insurance customers of 37%, both above the UK market average (sources: Retention rates GfK NOP Financial Research Survey (FRS) 6 months ending December 2011, 829 adults interviewed; Cross product holdings GfK NOP Financial Research Survey (FRS) 12 months ending December 2011, 750 adults interviewed).

The Group markets its Privilege brand directly to consumers in the United Kingdom through various channels including telephone, the internet and PCWs. The Group's Privilege brand targets customers who the Group believes have a lower need for support and advice, and who predominantly buy through PCWs, focusing on providing a quick customer experience at the best possible price. In 2011, 57% of motor consumers named Privilege as a brand they would consider buying, below the tracked market average (source: Nunwood Brand Tracking Survey). Consistent with the Privilege brand strategy of focusing on the best possible price, Privilege accounts for 0.5% of total Group advertising spending on its core own brands. Privilege offers most of the Group's products in the United Kingdom to individuals, though has historically focused only on motor insurance, and enjoys a customer retention rate among the Great Britain motor insurance market of 72% and a rate of cross-product holdings among Great Britain home and motor insurance customers of 26% (source: Retention rates GfK NOP Financial Research Survey (FRS) 6 months ending December 2011, 126 adults interviewed; Cross product holdings GfK NOP Financial Research Survey (FRS) 12 months ending December 2011, 61 adults interviewed).

The Group's other own brands include: Green Flag, the Group's primary roadside rescue and recovery service product, sold both as a stand-alone service and as an add-on to motor insurance; NIG, the Group's specialist commercial insurance brand, sold to SMEs in the United Kingdom through intermediaries including BIS, an in-house intermediary that brokers all the RBS/NatWest business; and DL4B, the Group's direct commercial insurance brand for SMEs in the United Kingdom.

Principal partner brands

The Group offers many of its core products, including motor, home, and rescue and other personal lines through the Prudential, RBS/NatWest and Nationwide partner brands under its distribution arrangements, and these three partner brands represented a significant portion of the Group's gross written premiums for the Group's home products in the six months ended 30 June 2012 and the years ended 31 December 2011, 2010 and 2009. Collectively, the Group's partner brands accounted for 28% of gross written premiums for the Group's UK personal lines business in the six months ended 30 June 2012 and 28% for the year ended 31 December 2011. The Group also offers commercial products through the RBS/NatWest brand. The Group offers home products through the Nationwide partner brand and motor and home products through the Sainsbury's partner brand. The Group also maintains several smaller distribution arrangements in both its UK and international businesses.

ONGOING BUSINESS SEGMENTS

The Group's five Ongoing reportable segments are motor, home, rescue and other personal lines, commercial, and international, of which motor, home, and rescue and other personal lines comprise the Group's "UK Personal Lines" business. The Group has other activities that comprise the Run-Off and Restructuring reporting lines (see Part XII: "*Operating and Financial Review—Discontinued and run-off business*" and this Part VII: "*—Run-Off Businesses*"). The Group employs its multi-brand strategy across each of its business segments.

Motor

The Group is the leading personal motor insurer in the United Kingdom in terms of in-force policies, with approximately 4.1 million in-force policies as at 31 December 2011 and 4.2 million in-force policies as at 30 June 2012, and a market share of 19% as at 31 December 2011 (source: Motor & Home market share data © GfK NOP Financial Research Survey (FRS) 3 months ending Dec 2011, 6,901 adults interviewed for Motor and 7,234 for Home). The table below provides certain information with respect to the Group's motor insurance business as at and for each of the years ended 31 December 2011, 2010, and 2009 and the six months ended 30 June 2012 and 2011:

	Six months ended 30 June 2012	Six months ended 30 June (unaudited) 2011	Year ended 31 December 2011	2010	2009
	(millions, £ except policies and ratios)				
Gross written premiums	842.1	866.0	1,734.8	1,902.2	2,067.2
Operating profit/(loss)	146.2	123.0	254.8	(416.9)	(132.0)
In-force policies	4.2	4.4	4.1	4.8	5.6
Combined operating ratio	102.4%	107.0%	105.6%	144.1%	125.7%
Current year combined operating ratio	115.7%	113.0%	113.4%	123.4%	120.9%

The UK motor insurance market

The UK motor insurance market is the fourth largest in Europe, with 28.4 million private vehicles as at 31 December 2010 (source: United Nations Statistical Database). While the market is mature, with car parc (a measure of the total number of cars in a country) growth at a CAGR of 1% since 2000 (source: Department of Transport Statistics 2012), it remains competitive, with the top five insurers accounting for only 56% of gross written premiums in 2010 (source: ABI Rankings 2010). Distribution of motor insurance in the UK has changed rapidly with the growth of PCWs, which originated 57% of new business in 2011, compared with 49% in 2009.

In recent years, and particularly since 2009, the UK motor insurance industry has been challenged by significant increases in motor bodily injury claims, longer settlement periods for bodily injury claims, greater incidence of fraudulent claims, the development of PCWs, increased penetration of claims

management companies and increases in no-win/no-fee arrangements. Despite these increases, the market average combined operating ratio for UK motor insurers remained at 106% in 2011 (source: Ernst and Young UK Motor Insurance Seminar). The UK motor insurance industry is also experiencing several regulatory developments that have impacted competition and overall industry performance. The most important of these regulatory developments are the new EU Gender Directive, the proposed ban on referral fees and other reforms led by Lord Justice Jackson, and the OFT investigation into competition in the UK motor insurance industry. For further discussion on these and other recent regulatory developments, see Part IX: "*Regulatory Overview—Recent developments*".

Products

Motor insurance policies are sold through the Group's own brands as well as key partner brands through distribution agreements. In addition to core motor insurance cover of third-party liability, fire and theft and accidental damage, the Group offers additional covers including motor legal protection and guaranteed hire car.

The Group's Direct Line and Churchill brands are the most highly recognised in the United Kingdom for personal motor insurance. The Group deploys these two brands along with Privilege and its partner brands across distinct customer segments in order to seek to maximise UK market penetration, tailor its product offering to those customer segments, and increase customer retention by developing deeper customer relationships.

As the leading personal motor insurer in the United Kingdom, in terms of in-force policies the Group seeks to utilise its scale to drive greater accuracy in pricing through more granular segmentation. This has been particularly important in the actions taken since 2009 to de-risk and re-price the Group's motor insurance business book following the losses incurred by the Group in 2009 and 2010. The Group continues to invest in its core insurance capabilities, including implementing a new claims management system and further enhancing its pricing capability through the utilisation of its overall operational scale and large customer data sets. See "*—Pricing*" and "*—Claims Management*".

Distribution

The Group sells motor insurance directly to customers over the phone, through its own-branded and partner-branded websites, as well as through PCWs. Currently, only the Churchill and Privilege own-branded products are available on PCWs, as are a number of the partner brands. In 2012 the Group began marketing its Churchill and Privilege brands on comparethemarket.com, the UK's largest PCW. In the United Kingdom, the Direct Line brand is only available through direct channels over the phone or internet and is not available through PCWs. As a result, while sales over PCWs have increased, the Group sells a significantly higher percentage of its motor insurance through phone and internet channels, when compared with the UK market generally. In 2010, as part of its overall effort to exit unprofitable business lines, the Group took the strategic decision to withdraw from the broker market for private motor policies.

New opportunities in the distribution of motor insurance include telematics, in which devices provide individual customer behaviour information, enabling insurance pricing based on actual driving behaviour. While historic use of telematics in the UK and Europe has been extremely low, the Group is running a telematics trial, which positions it to respond quickly to any changes in the market for this technology in the future should market demand develop.

Home

The Group is the leading personal home insurer in the United Kingdom in terms of in-force policies, with approximately 4.3 million in-force policies as at 31 December 2011 and as at 30 June 2012 and a market share of 18% as at 31 December 2011 (source: Motor & Home market share data © GfK NOP Financial Research Survey (FRS) 3 months ending Dec 2011, 6,901 adults interviewed for Motor and 7,234 for Home). The table below sets out certain information with respect to the Group's home insurance business

as at and for each of the years ended 31 December 2011, 2010, and 2009 and the six months ended 30 June 2012 and 2011:

	Six months ended 30 June 2012	Six months ended 30 June (unaudited) 2011	Year ended 31 December 2011	2010	2009
	(millions, £ except policies and ratios)				
Gross written premiums	484.4	500.8	1,031.3	1,034.4	1,030.9
Operating profit	18.4	40.4	111.9	163.1	170.8
In-force policies	4.3	4.4	4.3	4.3	4.3
Combined operating ratio	103.4%	98.6%	95.1%	91.0%	90.8%
Current year combined operating ratio	109.6%	87.0%	90.1%	98.1%	95.3%

The UK home insurance market

The UK home insurance market is the third largest in Europe, with approximately 27.0 million households in 2010 and relatively high rates of home ownership (source: Eurostat 2012). Approximately 19.6 million households have home contents insurance, and approximately 16.5 million have building insurance (source: ABI Key Facts 2011). The UK home market is concentrated, with the top three insurers (including the Group) accounting for a significant proportion of the market. While the market remains stable and mature, the sale of home insurance has historically been more profitable and less cyclical than the sale of UK motor insurance, with industry pricing characterised by relatively low introductory prices followed by increases on renewals. The UK average combined operating ratio for home insurance from 2000 to 2010 was 98.7% (source: ABI UK Operating Ratios). PCWs have begun playing an increasing role in the origination of new business in the UK home insurance market, though more traditional channels and retail branch sales sites remain important. The Company believes that PCW penetration levels are unlikely to reach those in the UK motor insurance market due to the lower average premium levels and the prevalence of distribution through cross-sales with mortgage products.

Catastrophic events and severe weather can cause significant volatility in claims from year to year, particularly in relation to floods, freeze, windstorms, and subsidence. Home insurance claims were particularly high in 2007 following the severe flooding across many parts of the UK, which the Association of British Insurers has estimated cost insurers a total of £3 billion (gross of reinsurance). In addition, unusually cold weather in the UK in December 2010 and unusually cold and wet weather in the UK in the first half of 2012 resulted in a significant increase in home insurance claims see Part XII: "*Operating and Financial Review—Results of Operations—Segmental Analysis—Home*".

Products

The Group sells home insurance policies through its own brands as well as key partner brands. In addition to core home insurance covers of buildings, contents, accidental damage and personal possessions, the Group offers additional covers including family legal protection and home emergency.

As with the Group's motor insurance business, the Group employs a multi-brand, multi-channel strategy in an effort to reach a wide customer base across the market. The Group's Direct Line and Churchill brands are the most highly recognised in the United Kingdom for personal home insurance. The Group seeks to deploy these two brands, along with Privilege and partner brands such as Sainsbury's, RBS/NatWest, Nationwide and Prudential across distinct customer segments so far as reasonably practicable in order to maximise UK market penetration and reduce the risk of its brands cannibalising customers from within the Group.

As the leading home insurer in the United Kingdom in terms of in-force policies, the Group seeks to utilise its scale to enhance pricing accuracy, including granular segmentation with a view to enabling a better understanding of overall risk. The Group has augmented its existing scale advantage by acquiring additional external data to enhance its pricing in certain key areas, particularly low frequency, high impact events such as catastrophes. The Group has also invested in geospatial software and data, as well as windstorm modelling tools and data, in order to more accurately price risk and manage geographic aggregation risk within its home business. Incorporation of external data and the new pricing systems with the Group's own internal experience has led to improved pricing model capability as well as increased sophistication in managing existing customers through renewal pricing. The ability to accurately manage pricing and lifetime customer value is particularly important in the UK home business, where industry

pricing is characterised by relatively low introductory prices followed by increases on renewals. To support its focus on enhanced pricing, the Group has also invested in a new operating model in claims management. See "*—Claims Management*".

Distribution

The Group sells home insurance directly to UK customers over the phone and through its own-branded websites, its distribution partner's-branded websites and branches, as well as through PCWs. As at the date of this Prospectus, only Churchill and Privilege own-branded policies are available on PCWs along with a number of the partner brands. The Direct Line brand is only available through direct channels over the phone or the internet and is not available through PCWs in the United Kingdom.

The Group has well-established partnerships for distribution of home insurance, allowing it to access key non-direct customer segments and generating high customer persistency rates. Sales through the Group's distribution partners comprise 54% of gross written premiums in 2011, with Nationwide, RBS/NatWest and Prudential accounting for the substantial majority. As a result of its sales through partner brands and its approach to the Direct Line brand, the Group sells a significantly higher percentage of its home insurance through partner branches, with comparatively lower sales on PCWs compared with the UK market generally, though the Group expects relative PCW sales to grow. In 2010, the Group took the strategic decision to withdraw from the broker market for private home policies due to its overall poor performance.

Rescue and Other Personal Lines

The Group is a leading rescue and other personal lines insurer in the United Kingdom, with approximately 9.2 million in-force policies as at 31 December 2011 and 9.7 million in-force policies as at 30 June 2012, and an estimated market share of 16.3% for 2011 within the Group's rescue business (source: Mintel Study 2011, excludes multiple personal, third-party and manufacturer memberships). The Group's rescue and other personal lines insurance business includes rescue and recovery insurance products as well as travel and pet insurance. The Group's rescue business comprises the most significant component of the segment, accounting for 41.7% of gross written premiums and contributed £54.2 million to operating profit (before taking into account any other operating income) during the year ended 31 December 2011. The table below sets forth certain information with respect to the Group's rescue and other personal lines insurance business as at and for each of the years ended 31 December 2011, 2010, and 2009 and the six months ended 30 June 2012 and 2011:

	Six months ended 30 June 2012	Six months ended 30 June (unaudited) 2011	Year ended 31 December 2011	2010	2009
	(millions, £ except policies and ratios)				
Gross written premiums	199.3	192.5	350.2	335.5	320.9
Operating profit	49.2	41.7	63.3	83.0	115.2
In-force policies	9.7	9.5	9.2	9.5	8.9
Combined operating ratio	75.7%	82.4%	86.3%	87.0%	81.9%
Current year combined operating ratio	82.3%	95.1%	99.8%	96.8%	87.9%

The UK rescue and other personal lines markets

Unlike other markets in which the Group operates, the UK rescue market is particularly concentrated with only three primary competitors, the AA, RAC, and the Group's Green Flag brand, which together account for approximately 92.4% of the total c.£1.5 billion market (by membership) (source: Mintel Study 2011, excludes multiple personal, third-party and manufacturer memberships). As with the UK motor insurance market generally, the UK rescue market has been stable and mature, with UK car parc relatively static. Despite the mature market, however, the UK rescue market has historically delivered steady growth and pre-tax profits to all three major competitors.

Products

The Group's Green Flag brand operates the United Kingdom's third largest roadside rescue and recovery service in terms of members as at 31 December 2011. Rescue insurance policies range from basic roadside rescue to a full Europe-wide breakdown recovery service. Both the AA and RAC employ flat fee models with owned and operated rescue fleets. By contrast, Green Flag employs a risk-based pricing model based

on data from its motor business and contracts out rescue fleets, resulting in a significantly lower fixed asset base. The Group maintains relationships with third-party automobile service garages and collision repair facilities throughout Europe, providing ready access to breakdown cover for its customers while maintaining controls over claims costs. The Group aims to grow Green Flag's contribution to the Group, investing in the recovery network suppliers and vehicle branding to reinvigorate the brand, targeting direct customer growth, improving operating systems and leveraging its large motor business to enhance cross-selling opportunities.

The Group is the fourth-largest travel insurer and third-largest pet insurer in the UK, with market shares of 11% in each based on 2011 gross written premiums (source: © A.M. Best Europe—Information Services Ltd.—used by permission). The Group believes these market positions are appropriate for its current business and is not seeking to grow significantly its pet and travel businesses. The Group's travel insurance policies cover medical expenses, financial default of travel suppliers and other losses incurred prior to or while travelling. The Group's pet insurance policies include cover for veterinary costs for pets that become ill or are injured in an accident, and can include coverage for loss, theft or death of the pet.

During 2011, the Group developed two new personal lines product offerings: income insurance and private insurance. Income insurance provides coverage for loss of income due to inability to work resulting from illness, accident or unemployment. Private insurance is a specialty offering to mid and high net worth customers, consisting of tailored home insurance (including valuables such as art), and can also include motor, pet and travel insurance. The Group sells private insurance directly to customers through personal sales and offers tailored services to meet individual policyholder needs. The Group sells private insurance through its own Direct Line brand as well as through RBS/NatWest and Coutts & Co partner brands.

Historically, the Group sold a small amount of life insurance through its Direct Line brand, and this business was included in the rescue and other personal lines segment. While the Group ceased writing new life insurance policies in 2011, previous policies remain part of the segment, and the Group expects the continued presence of those policies to affect the underwriting result of rescue and other personal lines going forward, although the reserves applicable to this business are an insignificant proportion of the Group's overall reserves.

Distribution

The Group sells its rescue insurance: (i) as a stand-alone product directly through the Green Flag brand; (ii) as an insurance add-on to all Group own brand and certain partner-branded motor policies; and (iii) as part of packaged bank accounts with RBS/NatWest as well as other partner brands. The Group aims to grow its Green Flag business by improving its direct internet site and offering Green Flag through PCWs. Currently, Green Flag has an approximately 25% linked phone cross-sell conversion.

The Group principally sells travel insurance in several ways, including: (i) as a stand-alone product directly to consumers through several Group brands; (ii) along side Group branded home insurance offerings; (iii) as part of packaged bank accounts with RBS/NatWest as well as other partner brands; and (iv) alongside and as a stand-alone product through the Group's partner brands.

The Group sells pet insurance direct to consumers as a stand-alone product under the Group's own brands only, leveraging cross-selling opportunities from both home and motor insurance, as well as through a limited number of small partner brands.

Commercial

The Group provides commercial insurance for micro businesses and SMEs in the United Kingdom, with approximately 0.4 million in-force policies as at 31 December 2011 and 0.5 million in-force policies as at 30 June 2012 and an estimated market share of 9% within the micro business and SME market as at 31 December 2011. The table below provides certain information with respect to the Group's commercial

insurance business as at and for each of the years ended 31 December 2011, 2010, and 2009 and the six months ended 30 June 2012 and 2011:

	Six months ended 30 June 2012	Six months ended 30 June (unaudited) 2011	Year ended 31 December 2011	2010	2009
	(millions, £ except policies and ratios)				
Gross written premiums	229.8	231.9	438.6	397.7	398.9
Operating profit/(loss)	(1.4)	9.4	(12.4)	(40.8)	5.3
In-force policies	0.5	0.4	0.4	0.4	0.3
Combined operating ratio	112.7%	103.7%	112.3%	121.6%	108.3%
Current year combined operating ratio	142.1%	120.2%	122.0%	137.7%	122.6%

The UK commercial insurance market

The UK commercial insurance market is estimated to represent £16 billion in annual gross written premiums, though most of it consists of insurance for large commercial enterprises. SMEs and micro businesses represent approximately 33% of the UK commercial market, accounting for an estimated £5.4 billion in gross written premiums in 2011 (source: Datamonitor UK SME Insurance 2011 report), an increase from £5.0 billion in 2009. The SME segment is characterised by regional broker distribution channels, though the proportion of gross written premiums sold via brokers to SMEs has fallen from 71% of total in 2009 to 56% in 2011. During that time, SMEs and micro businesses increasingly used broker e-trade and direct channels to purchase insurance, with e-traded polices having grown at a CAGR of 50% since 2010 (source: Acturis Study). The Group believes these trends are likely to continue and that the SME and micro segment is shifting toward a personal lines type of distribution model. The Board's current expectation, based on external research, is that by 2015, the UK SME and micro segment could grow to approximately £6 billion in gross written premiums, with direct and e-trade distribution accounting for around 80% of insurance sales.

Products

The Group provides commercial insurance for micro businesses and SMEs in the United Kingdom through its NIG and DL4B brands, as well as through its partner brand RBS/NatWest. The Group's commercial products include insurance cover for commercial property, business interruption, general liability, employers' liability and commercial motor. The NIG brand was acquired as part of the Group's acquisition of Churchill and remains its largest commercial insurance brand in terms of gross written premiums and the Group launched DL4B in 2007 to leverage the value of the Direct Line brand in the commercial insurance market, particularly among micro businesses. Since then, DL4B has grown from 4.3% of the gross written premiums of the Group's commercial insurance business in the year ended 31 December 2009 to 15.6% in the year ended 31 December 2010 to 17.5% in the year ended 31 December 2011, and the Group currently expects growth to continue.

Beginning in 2011, the Group rebranded the NIG brand, positioning itself as a challenger in the market, and began developing an e-trading distribution platform to take advantage of market trends. The first product launch on the e-trading platform occurred in September 2012 and the Group expects the next product roll-out to occur between November 2012 and February 2013.

The commercial business has access to the Group's large and diverse data pools as part of its improved pricing models and systems providing detailed pricing insight to the commercial market and the Group's claims management function. Through its multi-channel distribution model and investment in an e-trading distribution platform, the Group believes the commercial insurance business can benefit from the scale of the Group's overall insurance platform. The Board is aiming to achieve a target combined operating ratio for the Group's commercial business below 100.0% by the end of 2014.

Distribution

The Group offers commercial insurance under its NIG brand directly through an extensive network of insurance brokers and a branch network of eight regional centres and two specialist centres for agriculture and multi-cover policies. NIG supports its network of brokers through national and regional relationships. NIG also underwrites insurance for RBS/NatWest customers through the Group's in-house broker BIS, which also brokers such business to the external insurance market where NIG is unable to offer a suitable

solution. By contrast, as with other Direct Line products, DL4B is offered direct to businesses over the telephone and the internet. In the year ended 31 December 2011, £373.0 million of the gross written premium of the Group's commercial insurance business was generated through brokers, of which £289.3 million was sold through regional brokers and £83.7 million was sold through the broker e-trading platform. £99.9 million was generated through the direct channel, of which £82.7 million was sold direct through the brand and £17.2 million was sold through partnership channels. The Board intends to take advantage of what it believes is likely to be a trend for micro businesses and SMEs to migrate toward broker e-trading and direct distribution and focus on leveraging its core skills in direct distribution to build its commercial business.

International

The Group sells primarily motor insurance to private customers in Germany and Italy using a multi-channel strategy, with approximately 1.4 million in-force policies as at 31 December 2011 and 1.4 million in-force policies as at 30 June 2012. The Group is one of the leading providers of direct motor insurance in both Italy and Germany, evidenced by having the leading direct motor brand in Italy with a 31% market share in direct motor, and the third-largest direct motor brand in Germany with a 12% market share in direct motor.

The table below provides certain information with respect to the Group's international insurance business as at and for each of the years ended 31 December 2011, 2010, and 2009 and the six months ended 30 June 2012 and 2011:

	Six months ended 30 June 2012	Six months ended 30 June (unaudited) 2011	Year ended 31 December 2011	2010	2009
	(millions, £ except policies and ratios)				
Gross written premiums	302.8	302.0	570.0	425.5	353.7
Operating profit	11.8	(5.0)	4.3	5.9	6.3
In-force policies	1.4	1.3	1.4	1.1	0.9
Combined operating ratio	103.0%	112.5%	107.6%	107.9%	109.2%
Current year combined operating ratio	114.1%	121.2%	109.8%	121.6%	128.2%

The Italian motor insurance market

The Italian motor insurance market is the second largest motor insurance market in Europe, with approximately €20.7 billion for 2011 in annual gross written premiums (source: ANIA Report 2011) and 49.1 million vehicles. The Italian market is concentrated, with the top three insurers representing over 50% of the total market share, but includes 70 market participants in total with eight being direct insurers. The market is dominated by sales agents, which accounted for over 80% of total sales in 2011 (source: ANIA Report 2011). However, the direct and PCW channels have been the fastest growing platforms in Italy, accounting for 7.3% of the market in 2011 and driven in part by growth in e-commerce and increasing attention to price from customers and increasingly frequent switching of policies. After several years of weak economic growth and flat pricing for motor insurance, market prices began increasing again in 2010 and 2011, growing 7% and 5%, respectively.

The German motor insurance market

The German motor insurance market is the largest motor insurance market in Europe, with approximately €20.9 billion in annual gross written premiums for 2011 (source: GDV 18 April 2012 Study) and 50.9 million vehicles. The German market is fragmented, with the top five insurers representing approximately 35% of the market, and includes 100 market participants in total with 12 being direct insurers. The market is dominated by sales agents, which accounted for approximately 85% of total sales in 2011 (source: GDV Insurance Study 2011; GDV Direct Market Study 2010). As they are in Italy, however, the direct and PCW channels have been the fastest growing in Germany, accounting for 6.4% of the market in 2011 and driven in part by growth in e-commerce. The German market is also affected by seasonal renewals, with approximately 90% of motor insurance contracts renewing on 1 January each year. Following relatively flat pricing trends in the German motor insurance market from 2004 to 2009, premiums have begun to increase again, growing by 4% in 2011 (source GDV 18 April 2012 Study).

Products

The Group offers motor insurance in Italy and Germany and a very small amount of home insurance in Italy, in each case through its Direct Line brand. Direct Line is the leading direct motor brand in Italy, with unprompted brand awareness of 23%, well above its nearest direct motor insurance competitors (source: TNS, 2011), and the third largest direct motor brand in Germany, with market-recognised service quality and an efficient operating model. The Group also offers motor insurance through partner brands such as Fiat in Italy, and has been developing partnerships in Germany. Certain niche products are also offered such as mid-year renewal options in Germany where 90% of policies across the market as a whole normally renew on 1 January each year. Similar to the Group's UK business, the international business model is based upon the Group's strong brands and multi-channel distribution model.

Distribution

The Group distributes the majority of its international products through the direct channels of telephone and internet. The Group also offers its products in Italy and Germany through PCWs. Partner brands are offered through banks, financial institutions and the financial services arms of vehicle manufacturers. In Italy, the Group's partnerships accounted for 32% of gross written premiums in 2011.

PRICING

One of the primary initiatives in the Group's transformation plan has been improving its pricing models and systems. A key component of enhancing the Group's pricing has been the deployment of a new pricing engine, which the Group first began using in 2010, and which by mid-2012, handled all pricing in the Group's motor and home businesses. Along with the new pricing engine, the Group has been continuing to seek to improve its internal and external data collection, which it believes will support more accurate pricing of risk, as well as targeted marketing and sales efficiency. Since 2010, the Group has grown the number of full-time employees in its pricing function in order to support and develop the new pricing systems and data management.

Pricing data and systems

The Group benefits from some of the largest motor and home insurance data sets in the UK. In the UK motor market, the Group's leading scale and 27 years of history has given it a depth of experience with over 100 million cumulative motor vehicle years and over 5 million motor claims. The Group believes this pricing and claims experience can allow it to more accurately model claims development patterns and adjust its pricing accordingly, such as for large bodily injury and PPO claims. Similarly, the Group's scale and history in the UK home market has resulted in experience of over 3 million home claims, helping to deliver deep customer insight.

The scale of these data sets is augmented through the acquisition of external data sets and improved data feeds from PCWs, and as a result the Group accesses over 20 million quotes annually. The quality of the Group's data is further improved through central reconciliation and regular cleansing, which permits better data utilisation and increased technical and market pricing accuracy and sophistication within identified customer characteristics. Examples of Group data that support pricing include fraud data by postcode, affluence data by individual, vehicle data at the vehicle model level, and address level peril data (subsidence and flooding) for home insurance.

Together with improved data, enhanced pricing systems should allow the Group to seek to improve the depth and breadth of its overall pricing analysis, implement pricing changes more quickly and efficiently, and ultimately price its products more accurately. For example, the Group is currently able to implement rate changes on its pricing systems within a day, and implement changes to its pricing algorithms within four days. In 2009, prior to the improvements to its pricing systems, rate changes required four days and pricing algorithm changes required significantly longer to implement. The Group aims to further improve this efficiency to allow same-day rate changes and pricing algorithm changes by 2014 and is investing in geospatial data and software as well as windstorm modelling tools and data to provide more granular data and improved risk selection within its home and commercial businesses.

Pricing models

The new pricing engine has the capability to use multi-dimensional pricing models, which the Group intends to continue to improve with a view to enabling a more detailed level of pricing to be achieved

based on available data. The Group currently tests approximately 200 different risk factors under its new pricing models, twice the volume tested in 2009. The Group expects these new pricing models to more accurately model risk, account for elasticity and retention among customers, factor in life-time value of customers, and support tailored algorithms for different products and brands.

Beginning in 2009, the Group implemented a new motor risk model, followed by a new home risk model. This was followed in 2011 with the implementation of motor combined peril level risk models, which aim to ensure policies are written at an estimated loss ratio within the Group's underwriting tolerances. In 2012, this is being further improved to implement peril level risk models directly within the rating algorithms for home insurance, with motor insurance planned for 2013 improving the accuracy of the Group's modelled risk cost estimate and narrowing the estimated distribution of loss ratios.

As a result of improving its pricing models and systems, the Group has been able to make significant changes to its risk mix, particularly for motor insurance, where the Group has reduced its overall exposure to higher risk policyholders, such as young drivers, and to update its pricing models to more accurately reflect technical pricing information. These models and systems have also allowed the Group to improve its market pricing in its motor business with the ability to set prices within the context of strategic growth objectives, taking account of price elasticity, and expected retention rates, with future developments to include the potential for cross selling, and other customer lifetime value metrics, all at the individual customer level. The Group believes that, over the medium term, increased sophistication in pricing and underwriting should help to ensure it manages its risk/reward profile more appropriately.

CLAIMS MANAGEMENT

The Group's claims function manages claims activities for all UK insurance products across all its segments and product lines. A core component of the Group's transformation plan is improving the infrastructure that supports the Group's current UK claims management processes, which, at the initiation of the Group's transformation plan, did not facilitate the competitive advantage that a centrally-managed UK claims function could provide to the Group.

The majority of the Group's net UK insurance claims expenditure from ongoing business relates to motor claims. Of the Group's net UK insurance claims from ongoing businesses of £2,600.5 million in the year ended 31 December 2011, 57.4% or £1,493.8 million was for the Group's motor insurance business, of which £770.9 million related to motor bodily injury claims. Bodily injury claims remain the UK motor industry's largest area of claims uncertainty, with recent trends in large bodily injury claims and PPOs making the estimation of future claims increasingly complex. The Group's home business is the second largest source of claims expenditures, accounting for 23.8% or £618.4 million of net insurance claims from the Group's ongoing business during that period. Claims in the Group's home business tend to be stable over the long term, with volatility in any particular year mainly due to weather and other catastrophic events.

The claims function uses a number of different metrics to evaluate claims performance, including average incurred severity inflation, average settled claims cost, litigation rates, and settlement rates and timing. With respect to claims management, the UK claims function uses internal resources, including claims advisors, property assessors, motor engineers and wholly-owned UK Assistance Accident Repair Centres, as well as a wide range of external providers, to register, evaluate, manage, fulfil, handle and close claims. In addition, certain specialised claims management segment functions are outsourced (including subsidence). External resources include solicitors, medical experts, garages, loss adjusters, builders, and household goods suppliers. The Group uses various audit activities both internally and externally across claims in an effort to enhance appropriate, efficient and effective claims handling.

The Group believes that an efficient and effective claims management system and associated processes are key to providing superior customer service and controlling claims costs, and the Group applies this philosophy throughout all its claims functions, including, increasingly those in Italy and Germany. Historically, the Group has faced challenges to efficient and effective claims management resulting from complex, outdated and geographically fragmented operations causing inconsistencies, inadequate performance management, lack of proactivity in managing difficult claims, particularly motor bodily injury, and insufficient integration with pricing and actuarial functions. The Group's UK claims function is aiming to improve the performance of its claims operating systems and processes to enable it to manage the cost of claims below market claims inflation and provide enhanced customer satisfaction, through for example faster response times. The UK claims function is particularly focused on efforts to enhance its proactive management of third-party claims and to reduce claims fraud and inefficiencies in the claims systems and

procedures, which, combined with other improvement initiatives, would be expected to enable savings. As part of its overall Group transformation plan, the UK claims function is currently undergoing its own improvement programme, which aims to address the complexity, speed and fragmentation of its claims processes. In 2011, the Group implemented a new claims management system and plans to bring the majority of new UK claims onto one common system by the end of 2013. All new motor claims for the Group's own brands have been processed on the system since the end of 2011, with over 320,000 claims registered through the first half of 2012, and all new home claims are scheduled to be processed on the system by the end of 2012 with commercial claims following in 2013. The new system has been designed to improve customers' claims experience and aims to ensure more efficient and effective claims handling through faster, more accurate claims resolution and simplified coverage validation. Strategic next steps include simplification of the claims function in the Group's home and motor insurance business.

Other prospective improvements to the Group's claims function are undergoing a testing process in which challenges are identified and solutions are conceived, pilot tested and once demonstrated, implemented across the claims function. For example, the Group recently concluded a bodily injury pilot programme, refocusing efforts within a subset of bodily injury claims on rapid identification and contact of third-party customers, blended legal, medical and insurance teams, and a more proactive and targeted approach to case management. This pilot delivered faster settlement times at lower overall claims cost and lower litigation rates, resulting in a 17% reduction in claims costs within the pilot study. The Group plans to roll out this initiative across all motor bodily injury claims. In addition, the Group has introduced or is in the process of implementing several other improvement initiatives, including revised processes for fraud detection, motor vehicle and building damage, third-party repair and hire and evaluation as well as subsidence claims. The Group's UK claims function is also in the process of consolidating its geographic operations, from 21 operating sites in 2010 to a targeted 9 sites by 2013, as well as reducing its overall headcount, from 5,430 full-time employees in 2010 to a target 4,300 by 2013. See also "*—History of the Business—Development of the Group*".

While the Group expects to implement much of the claims transformation programme for its UK claims management in the next few years, many of its initiatives are still in progress, and some remain in early development stages. However, the Group has begun to experience benefits from these initiatives, with lower rates of claims inflation, lower litigation rates, and improved settlement rates, particularly from motor bodily injury, from 2009 to 2011.

The Group is actively engaged in industry lobbying and related consultation, and supporting the introduction of a coherent package of legal reforms and will prepare for any regulatory changes resulting from the OFT enquiry into hire vehicles and repair (see Part IX: "*Regulatory Overview—Recent developments—Market study into motor insurance by the Office of Fair Trading*").

Each of the Group's international businesses in Italy and Germany operate separate claims functions. These functions are modelled on the Group's UK insurance claims function and leverage the knowledge and capabilities of the Group's overall claims expertise, but are tailored to the individual requirements, regulations and practices in each of their respective markets. Over time, the claims function of the Group's international insurance business should be able to leverage the benefits of the UK claims transformation programme.

REINSURANCE

The Group purchases reinsurance to protect its capital position as well as the results of individual business lines. The primary objectives of the Group's reinsurance programmes are to reduce the volatility of the Group's overall underwriting result, improve the stability of earnings for relevant business lines and transfer out of the Group risks that are outside of the Group's current risk appetite.

The Group seeks to achieve these objectives by transferring certain identified insurance risks out of the Group in the form of reinsurance. The overall analysis of which major reinsurance programmes to purchase utilises the same models and methodology as those used for evaluating regulatory and economic capital requirements. The Group seeks to reduce volatility in its underwriting results and support its capital base through purchasing reinsurance for catastrophes and other major individual or accumulation losses. The retained portions of insurance risk are managed at levels that the Group expects it can absorb in accordance with loss models and regulatory capital requirements. The Group seeks to purchase reinsurance at cost effective rates from secure reinsurers within credit risk levels acceptable to management.

The Group purchases reinsurance to provide cover against other substantial individual claims or an accumulation of claims arising from a catastrophe event such as wind, storm or flood. The Group has a property excess of loss catastrophe reinsurance cover with a retention of £125 million per event. This cover has one reinstatement at 100% additional premium. In addition, the Group's international insurance business has liability excess of loss covers with relatively low retained deductibles and coverage up to the statutory minimum for the territories concerned. Small "own damage" covers are placed and reinsurance is purchased for the Group's Italian business to cover a portion of the entire portfolio of policies underwritten (also known as "quota share reinsurance"). The Group is also a member of Pool Re, which offers reinsurance coverage for UK commercial claims arising from terrorist attacks.

Reinsurance procurement controls and monitoring

The purchase and ongoing management of the Group's reinsurance covers are subject to strict governance and approvals, with differing levels of approval required depending on the extent of the reinsurance proposed and the anticipated level of premium expenditure. Maximum purchasing and retention levels are set by the Board and with relevant members of senior management while the reinsurance function executes purchasing and monitors reinsurance activities. UK Catastrophe and the Group's motor insurance business covers must be approved by the Board due to the levels of expenditure. All covers for the Group's Italian and German businesses are approved by the Group's Italian or German company boards, respectively and Group governance is applied. Additionally, the reinsurance arrangements and programmes in the Group's international business are formally reported to the respective regulators annually. The Group performs an annual review on its catastrophe and motor reinsurance programmes and their impact on the Group's required capital, retained and/or ceded profit and earnings volatility.

Assumed credit risk for the Group's reinsurance is monitored monthly by the Credit Risk Investment Forum, a governance committee. The assumed credit risk for the Group's reinsurance exposure is also aggregated over the RBS Group, which could limit the Group's ability to purchase cover from certain reinsurers, and the Group expects this will continue for as long as the Group remains under majority control by the RBS Group. See Part II: "*Risk Factors—Risks relating to the Group—Reinsurance may not be available, affordable or adequate to protect the Group against losses, and reinsurers may default on their reinsurance obligations*".

The purchase of reinsurance does not discharge the Group from any liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the Group remains liable for the payment to its customers. Therefore, the Group considers the creditworthiness of reinsurers based on their financial strength prior to finalising any reinsurance contract. The Group uses selection criteria for assumed reinsurer credit risk based on Standard & Poor's and/or AM Best (both registered in the EU) financial security ratings and other publicly available information, and augments the selection process with reports from its reinsurance brokers as well as regular meetings with its panel of reinsurers.

Unless otherwise approved, the Group's primary credit rating requirements for reinsurers at the time of purchase are "AA−" or better (with only a limited amount of "A+") for motor and liability excess of loss (long-tail) reinsurance, and "A−" or better for property individual risk and catastrophe excess of loss (short-tail) reinsurance. In a majority of its property individual risk and catastrophe excess of loss reinsurance contracts, the Group also requires a security downgrade clause in the reinsurance contract, providing the Group with the option to replace a reinsurer should it be downgraded below the Group's minimum security threshold rating. These security requirements may vary for other covers.

RESERVING

The Group holds technical reserves to ensure it has sufficient funds available to pay its insurance liabilities when they fall due. The Group's technical reserves consist of:

- claims reserves (including for claims incurred but not reported) to cover the future cost of claims that have occurred prior to the balance sheet date to ultimate settlement, net of reinsurance;
- unearned premium reserves, net of reinsurance;
- loss adequacy reserves, to cover any expected shortfall in unearned premiums reserves for portfolios of business;

- claims handling expense reserves, in respect of unallocated loss adjustment expenses, to cover the unallocated cost of handling all claims which have occurred prior to the balance sheet date to ultimate settlement; and
- reinsurance bad debt reserves, which allow for future non-performance of reinsurance contracts.

The majority of the Group's technical reserves are held to pay motor claims in both the United Kingdom and overseas. Approximately two thirds of the Group's technical reserves are held to pay motor bodily injury claims, which are long-tailed by nature.

Determination of the Group's technical reserves is a complex process, involving analysis of trends in claims costs and payment patterns using a range of actuarial and statistical methods as well as wider impacts to the Group's business, such as market and economic trends. Technical reserves for PPOs, latent claims and reinsurance are determined using bespoke models developed by the Group. The technical reserves held by the Company are subject to risk from wider market changes, such as changes in consumer behaviour (e.g. in relation to the economic environment and fuel prices), changes in the economy, changes in the level of inflation and changes in legislation, which may impact retrospectively as opposed to just prospectively (e.g. changes in the discount rate used to calculate lump sum awards for injured claimants). See Part II: "*Risk Factors—Risks relating to the Group—The Group's technical reserves may not adequately cover actual claims*".

As at 30 June 2012, the Group's total general insurance liabilities (including a provision for adverse reserve movement), on a net of outwards reinsurance outstanding claims provision, totalled £5,601.5 million and includes the TPF non-life general insurance liabilities. This exceeded Towers Watson's corresponding estimate by 7.1%. See Part XV: "*Actuarial Report*".

Reserve process initiatives

As outlined above, the Group's transformation plan has involved changes to a number of processes and procedures within the Group, including in relation to reserving. The Group took this action in response to both external factors, including the changing trends in the frequency and severity of bodily injury claims occurring in the market, and internal factors, including inaccuracies in reserving that arose from the changing trends in individual claims settlements occurring within the Group's claims function. Drivers of external trends included increases in the propensity of PPO settlements, partially driven by the prevailing low interest rate environment, poorer investment outlook and a court ruling for the payments in respect of future cost of care to be linked to the Annual Survey of Hours and Earnings rather than the traditionally lower Retail Price Index, expectations with respect to possible changes to the Ogden discount rate, increased penetration of claims management companies pursuing more bodily injury claims, and increases in the prevalence of fraudulent claims. These issues resulted in the Group significantly increasing its technical reserves in 2009 and 2010 and changing its claims and reserving operations, processes and procedures.

While there can be no assurance that adverse trends in bodily injury or other types of claims will not occur in the future, driven by numerous potential causes (see Part II: "*Risk Factors—Risks relating to the Group—The Group's technical reserves may not adequately cover actual claims*"), the Group believes the changes it made during 2009 and 2010 to its underlying processes and procedures and reserves held were appropriate. Moreover, the Group believes that, having improved its reserving modelling, processes, controls and governance procedures, it should be better able to identify and mitigate significant emerging trends.

Reserving policy and controls

The Group employs actuarial and other techniques to estimate the expected ultimate value of claims, and associated unpaid liabilities in respect of business which has been earned up to the balance sheet date. These liabilities are estimated net of recoveries from third parties, such as other insurers, and net of reinsurance recoveries. The ultimate value and corresponding unpaid liability is estimated on an undiscounted basis for all claim types except reserves held to cover the expected claims cost in relation to PPOs which are assessed on a discounted basis.

In particular, the estimation of technical reserves in relation to PPOs is complex and uncertain due to the increased range of assumptions required, including the future propensity of such settlement methods, estimated rates of indexation, estimated mortality trends for impaired lives, payment patterns, investment income and the impact of reinsurance recoveries. Further, as the reserves are assessed on a discounted basis, the discount rate which the Group applies is also a significant element of this estimation process.

Currently, the estimated cost of PPO claims is based on an assumed indexation of 4.5% in relation to the future cost of care. In conjunction with this, in the year ended 31 December 2011, the Group applied a 4.5% discount rate to the assessment of technical reserves in relation to the estimated costs of PPO claims. The Board has approved an asset to liability matching strategy in respect of the assets backing these technical reserves, which uses a long term investment assumption of 4.5% per annum, therefore implying a real discount rate of 0.0%.

As at 30 June 2012, the total discounted technical reserves in relation to the estimated costs of PPO claims (including claims incurred but not reported) for the Group's ongoing business, including both the lump sum and the annual payment elements, was £1,268.1 million gross and £855.9 million net of related reinsurance. On an undiscounted basis, total technical reserves in relation to the estimated costs of PPO claims (including claims incurred but not reported) for the Group's ongoing business was £4,218.8 million gross and £2,448.4 million net of related reinsurance as at 30 June 2012.

The Group also maintains an unearned premium reserve in respect of premiums not yet earned at the balance sheet date. Unearned premium reserve represents the proportion of the premiums that have been written prior to the balance sheet date but which relate to periods of risk after the balance sheet date. Provision is also made where necessary for the estimated amount of claims and expenses over and above unearned premiums. The provision is designed to meet future claims and related expenses and is calculated across related classes of business allowing for deferred acquisition expenses and investment income.

The Group conducts actuarial reviews on a regular basis for material reserves. Such reviews are either undertaken internally or by utilising suitable external independent resources. The Group also subjects its internally derived actuarial best estimate reserves to independent external peer review at least annually.

The Group holds reserves in excess of the actuarial best estimate reserves as provision for adverse reserve movements given the natural uncertainty which exists in the actuarial best estimate reserves. These additional reserves are determined by the Board based on a consideration of the risks underlying the assessment of the actuarial best estimate reserves, including, but not limited to, the level of process and parameter uncertainty inherent in actuarial techniques, the level of uncertainty in the standard claims handling processes; potential pricing and underwriting risks; emerging risks; and short and long term binary-type risks not allowed for in actuarial best estimate methodology. The actuarial best estimate reserves, together with the additional provision for adverse reserve movements, forms the overall management best estimate of Group reserves, which is booked in the accounts.

The Group's actuarial and recommended management best estimate reserves are subject to review by various committees and the Board on at least a semi-annual basis. Recommendations for levels of reserves are then presented to the Group's Board, which decides upon the level at which the reserves should be booked.

In addition to the Group's financial reporting, reserve reviews inform management action on claims, pricing, underwriting, reinsurance purchasing, capital modelling and forecasting.

Insurance liabilities

The table below sets forth the Group's insurance liabilities (i.e. technical reserves), unearned premium reserve and reinsurance assets as at 30 June 2012, net of reinsurance:

	Gross	Reinsurance assets	Net
		(£ millions)	
Claims reported	3,978.8	(371.8)	3,607.0
Loss adjustment expenses	147.9	—	147.9
Notified claims	**4,126.7**	**(371.8)**	**3,754.9**
Liability adequacy provision	11.8	—	11.8
Claims incurred but not reported	2,273.9	(439.1)	1,834.8
Total general insurance liabilities	**6,412.4**	**(810.9)**	**5,601.5**
Life insurance business	102.2	(88.8)	13.4
	6,514.6	(899.7)	5,614.9
Unearned premiums	1,946.7	(64.5)	1,882.2
Total	**8,461.3**	**(964.2)**	**7,497.1**

CAPITAL RESOURCES

Capital management policy

The objective of the Group's capital management policy is to ensure that the Group manages its capital efficiently and maintains an appropriate level of capitalisation and solvency. The Group determines the appropriate level of capital on the basis of a number of criteria including its risk-based capital requirement, the maintenance of a prudent excess versus regulatory capital requirements, and the objective of ensuring consistency with a credit rating in the "A" range. The Group also manages its subsidiaries on an ongoing basis to ensure that capital resources exceed regulatory minima in accordance with its current requirements.

The Group's leverage policy is to manage financial leverage consistent with its objective of maintaining a credit rating in the "A" range.

Risk-based capital

The Group uses a risk-based capital model, as part of its individual capital assessment ("**ICA**"), to determine how much capital it needs to maintain to operate in accordance with its risk appetite and strategy for the UK general insurance underwriters established within its enterprise risk management framework (see "*—Risk Management—Enterprise-wide risk management framework*"). The risk-based capital model also supports decision making in the business.

The Group determines its risk-based capital requirement based on the relative importance of the business risks taken. As at 31 December 2011, the insurance risk constitutes 72% of the total risk-based capital requirement as a result of risks inherent to underwriting and reserving for motor insurance. The Group has minimal exposure to life insurance risk at 1%. Market risk is comparatively modest at 11% of risk-based capital requirement, reflecting the Group's conservative investment policy. Operational risk reflects risks associated with running a large organisation, and constitutes 10% of risk-based capital requirement. Credit risk constitutes 6%, driven by counterparty exposure to reinsurers and banks with whom it has deposits. The Group expects to continue developing its model in line with emerging Solvency II requirements.

The overall risk-based capital requirements are calibrated to a 99.5% confidence interval over a one year time horizon, and the Group seeks to hold capital resources in the range of 125% to 150% of risk-based capital. In addition, the Group also monitors financial resources with reference to the requirements of the IGD. At 30 June 2012, the Group's risk-based capital coverage ratio was 160.0%.

FSA individual capital adequacy

The UK regulated entities of the Group carry out an assessment of the adequacy of their overall financial resources in accordance with the ICA methodology. This is based on an internal capital model which is calibrated, as required by the FSA, to a 99.5% confidence interval over a one year time horizon. As stated above, the Group's capital risk appetite is to hold capital consistent with the Group's maintenance of a

credit rating in the "A" range and as such its capital resources are in excess of the ICA requirement. The capital for European entities is maintained in accordance with the local regulatory solvency requirements.

Credit ratings

Standard & Poor's and Moody's provide insurance financial strength ratings for U K Insurance, the Group's principal UK general insurance underwriter. U K Insurance is currently rated "A" with a stable outlook by Standard & Poor's and "A2" with a stable outlook by Moody's. Standard & Poor's and Moody's currently link the financial strength ratings of U K Insurance to the overall rating of the RBS Group. As a consequence, Standard & Poor's has indicated that, while RBS Group has a (direct or indirect) majority shareholding in U K Insurance, its rating for U K Insurance could be affected by future rating actions on the RBS Group. Moody's has indicated that its rating for U K Insurance could be negatively impacted by a material weakening of the RBS Group's credit profile as reflected in any further downgrade in the RBS Group's ratings or any delay to the divestment of the Company from the RBS Group.

Dividend policy

The Group aims to generate long-term sustainable value for shareholders while balancing operational, regulatory, rating agency and policyholder requirements. The Board has adopted a progressive dividend policy for the Company which will aim to increase the dividend annually in real terms to reflect the cash-flow generation and long-term earnings potential of the Company.

It is expected that one-third of the annual dividend will be paid in the fourth quarter as an interim dividend and two-thirds will be paid as a final dividend in the second quarter of the following year. The Board may revise the dividend policy from time to time.

In addition, if the Board believes the Group has capital which is surplus to the Board's view of its requirements, it is intended that it will be returned to shareholders. The Company may consider a special dividend and/or the repurchase of its own shares as a means to distribute surplus capital to shareholders.

Following Admission, if the Company makes a post-tax profit in respect of the relevant period, it intends to pay a final dividend for the financial year ending 31 December 2012 which, in accordance with the above dividend policy, will represent two-thirds of the pro-forma annual dividend. If payable, any dividend would be based on a payout ratio between 50% and 60% of any consolidated post-tax profit from the Company's ongoing operations before restructuring costs for the financial year ending 31 December 2012. If paid, the Board currently expects this dividend will be used as a base for future dividend payments.

However, the ability of the Company to pay dividends is dependent on a number of factors and there is no assurance that the Company will pay dividends or, if a dividend is paid, what the amount of such dividend will be (See Part II: "*Risk Factors—Shareholders may earn a negative or no return on their investment in the Group*").

Solvency II

The Group's Solvency II programme is scheduled to meet implementation requirements and milestones, and the Group participated in Quantitative Impact Study 5. Significant progress has been made to date, including the delivery of the technology infrastructure, and the first stages of the Solvency II data warehouse and risk management system. Development of the internal capital model and embedding Solvency II processes within the business are ongoing in preparation for the submission by U K Insurance of its internal model for approval. Given the uncertainty surrounding the substantive requirements of Solvency II, including the date of its implementation, there can be no assurance that the Group will not need to strengthen its solvency capital position.

INVESTMENTS

The Group makes investments primarily to cover its technical reserves. The Group aims to manage its portfolio to maximise return relative to the Group's risk appetite and to serve as a stable income generator while providing a match to the Group's technical reserves and liquidity needs. In 2011, investment return decreased somewhat, with lower yields partly offset by higher realised gains.

As the majority of the Group's liabilities are short-tailed, fixed income investment constitutes a major part of the investment portfolio. A large portion of the portfolio consists of cash, gilts and other bonds, see Part XII: "*Operating and Financial Review—Investment Assets*". The Group's overall investment portfolio

consists of two primary individual portfolios, the UK core portfolio, which covers the Group's UK business (other than its business with TPF which is currently being run off, see "—*Run-off businesses*"); and its euro-denominated international portfolio, which covers the Group's international business. The TPF portfolio, which covers the run-off liabilities associated with that partnership arrangement, is currently segregated from the remaining portfolio and, following the effective closure of the arrangements with TPF, any remaining investments will form part of the UK core portfolio.

Prior to 2011, responsibility for managing the investment and treasury function for the insurance business was housed within the RBS Group's central treasury function. As part of the separation process from the RBS Group, the Group has established a separate investment and treasury function, reporting directly into the Group's finance director. Cash and gilt portfolios are managed directly by an in-house team while management of other asset classes is awarded to leading external managers. In addition, the Group has implemented new systems to provide better investment accounting, reporting, analytics, and risk management as well as to support front office dealing activities.

Investment strategy and controls

The investments of the Group are managed within the limits of the Group's investment guidelines, which are based on overall risk and target income. This management is done by its investment and treasury function, incorporating the use of appropriate mandates for external managers where appropriate.

In connection with the establishment of a separate investment and treasury function, the Group has begun managing its investment portfolio based on the following criteria, the effects of which are expected to be realised over the medium term:

- To ensure liquidity, the portfolio must include a minimum of 10% in cash;
- The target asset mix for the UK core portfolio is approximately a maximum of 60% credit, minimum of 10% gilts, minimum of 10% cash, and a maximum of 5% property;
- Within credit investments the minimum acceptable investment grade at purchase is BBB (positions falling to BBB− must typically be sold within 30 days);
- Derivatives are permitted for risk management only (gearing not allowed);
- No investment in the sovereign debt of Greece, Italy, Ireland, Portugal or Spain; and
- No investment in equities.

As at 30 June 2012, the Group's investment portfolio consisted of 100% debt securities and cash.

As part of the implementation of the new investment management function and the incorporation of external managers, the Group's investment portfolio as at 30 June 2012 is closer to its maximum allocation of 60% credit, as a result of its investment of approximately £400 million in US dollar corporate credit, which is hedged back into pounds sterling. In addition, the Group is considering future changes to the nature and type of investment portfolio it holds with the aim of increased diversification, through changes in the mix of asset type, duration, currency and denomination. In particular, the Group is considering investing a portion of its assets in real estate. The Group may in the future invest in other asset classes.

The international portfolio is centrally managed by the Group's investment and treasury function.

Effective implementation of the Group's investment strategy requires monitoring of the different risks affecting its portfolio. The risk framework surrounding investment activity, including counterparty limits, minimum required investment grade, and liquidity requirements are approved by an appropriate committee. The Group's risk function operates a variety of processes in order to act as an independent arbiter of the appropriateness of and compliance with approved investment risk parameters and limits through its own assessment and formal meetings with the Group's investment and treasury function, escalating key concerns to the relevant higher committee.

RISK MANAGEMENT

Risk management, incorporating the identification, assessment, management, control, reporting and mitigation of risk, is a fundamental part of the daily operations and ongoing performance of the Group. The Board believes the Group's enterprise-wide risk management strategy and framework will support the Group in achieving its strategic risk objectives, namely maintaining capital adequacy, managing earnings volatility, ensuring stable and efficient access to funding and liquidity, and maintaining stakeholder

confidence, including protecting policyholder interests and continuing the Group's focus on treating its customers fairly.

The Board has overall responsibility for the risk and control environment in the Group, including setting the Group's risk appetite, risk strategy and target operating model, and risk management and internal control systems.

The Board is supported by the Board Risk Committee, as well as the risk and internal audit functions. These functions define, oversee and challenge the risk and control environment of the Group, including the operation of the business within its risk appetite. The risk function advises the Board Risk Committee on risk appetite and supports the business by maintaining the risk management framework and defining the associated processes. The Group's internal audit function provides assurance to the Audit Committee over the adequacy and effectiveness of the design and implementation of the Group's internal control systems, including the risk management framework.

Enterprise-wide risk management framework

To achieve its overall risk management objectives, the Group has adopted an enterprise-wide risk management strategy and framework, which it expects to continually enhance in the future. The key elements of this strategy and framework are described below.

The Board oversees the business operations within the Group, aimed at ensuring competent and prudent management and the maintenance of adequate procedures for accounting, financial and other records management as well as compliance with statutory and regulatory obligations. Key aspects of the Board's ongoing oversight of the risk strategy and enterprise-wide risk management framework includes items such as the receipt of regular reports, an annual review of the risk appetite framework, the ICA assessment for the UK regulated entities, and use of the capital model in decision making.

The Board has responsibility for approving the methodologies, approaches and assumptions used to identify, measure, monitor, report, control, and mitigate the Group's risk exposures and, hence, overseeing and challenging the risk and control environment of the Group. The Board delegates its authority to the Board Risk Committee, which has responsibility for the oversight of the Group's risk and regulatory framework and the design of the Group's control environment, and the Audit Committee, which receives assurances from the Group's internal audit function over the adequacy and effectiveness of the same. The Board Risk Committee and the Audit Committee are committees of the Board composed of independent non-executive directors which meet a minimum of once a quarter. The Board Risk Committee's responsibilities include:

- ***risk profile and appetite:*** reviewing, approving and providing recommendations on the risk appetite framework to the Board, monitoring and proactively challenging the risk performance of the Group and reports from the risk and compliance functions;
- ***risk strategy and policy:*** reviewing the implementation of risk management strategy and policy across the Group, monitoring the adequacy and effectiveness of the Group's internal control framework and considering the Group's risk profile; and
- ***risk management operating model:*** approving the risk and compliance plans and considering the adequacy and effectiveness of resources dedicated to risk management and internal control, including the risk and compliance functions.

The managing directors of the Group's business and support functions operate a range of committees and other forums to oversee risk within their areas of responsibility (e.g. pricing committees and loss ratio committees).

The Group has adopted a "three lines of defence" operating model. The Group believes this approach is a best practice standard for companies in the financial services sector. The Group's risk function, including its compliance function, forms the second line of defence and is managed by the Chief Risk Officer. The Chief Risk Officer is a member of the executive committee and has a reporting line to the Chief Executive Officer, with a right of access to the Board Risk Committee and the Audit Committee, assuring independence of the function. The Chief Risk Officer chairs the executive Risk Management Committee, which reviews material policies for the effective management of risk across the Group, including those associated with Solvency II. The risk function produces a report each month to the executive Risk Management Committee, the executive committee and the Board that covers the material risk considerations for the Group, including details of any new and emerging risks.

The role of the executive Asset and Liability Committee includes monitoring the solvency position of all of the Group's regulated entities as well as the Group overall. It also considers options to appropriately optimise the Group's capital in accordance with all regulatory and Board requirements and objectives, in order to maximise the capital efficiency and return on capital of the insurance regulated entities and the Group as a whole.

The role of the executive Reserving Review Committee, which meets at least quarterly, is to review and oversee the claims development trends and technical reserves. In addition, there are other forums which consider and oversee specific risk types (e.g. the insurance risk forum).

The Group has developed a policy framework to govern its risk and control activities and expected behaviours across all of its businesses. The policy framework has been formed under an overarching enterprise-wide risk management policy. Within this framework, each policy governs a particular risk type (e.g. insurance risk and market risk) and is supported by a range of minimum standards, which detail the minimum level of compliance required and the behaviours expected. The Group employs a range of other processes as part of its enterprise-wide risk management framework covering areas such as key assessment, key risk indicators, stress testing and scenario analysis, issue management, event and data loss management and business continuity management.

Risk appetite and strategy

The Group's risk appetite framework is reviewed and approved by the Board, taking into account the business strategy and risk strategy. It incorporates a series of strategic risk appetite statements assigned to the strategic risk objectives, which form the framework around the Group's overall risk appetite objectives and cover all principal risk types. While these risk appetite statements cover the Group as a whole, each business and support function has developed its own risk appetite statements which support the overall Group risk appetite.

The Board's appetite is predominantly for general insurance risk, with other exposure being consequential to this, as required for the Group to undertake its primary activity. The oversight and management of insurance risk is, therefore, a key responsibility of the Board and its associated committees.

Insurance risk management

As the largest risk to which the business is exposed, the oversight, management and control of insurance risk is considered of strategic importance to the Group. In particular, insurance risk is monitored by the Board Risk Committee and the Risk Management Committee. The Group has a range of functions, processes and controls in place to manage insurance risk across the Group, such as:

- ***pricing and underwriting functions:*** responsible for setting, developing and monitoring the pricing and underwriting strategy; setting annually reviewable personal underwriting authorities and limits, where appropriate; developing and implementing product underwriting manuals; defining policy terms and conditions; setting prices for the majority of business underwritten; and seeking to ensure at all times that the businesses operates within the Board approved risk appetite;
- ***claims function:*** responsible for the implementation and management of appropriate claims policies and procedures, including reserving and payment authorities where appropriate; appropriate, timely and cost effective handling and settlement of claims; developing and monitoring relevant, current management information to enable the identification of potential and emerging claims trends that could impact claims management, costs and/or reserving processes; and interacting with relevant functions to ensure the detailed understanding of claims development patterns to assist in overall pricing and reserving processes;
- ***reserving function:*** responsible for determining the actuarial best estimate reserves, including provisions in respect of the requirement for claims handling expenses, liability adequacy reserves and reinsurance bad debt, for each product based on a range of data and other information, including assessing the uncertainty in these estimates to help the Board determine the management best estimate; responsible for booked reserves and ensuring all elements are documented in accordance with required records management procedures and professional guidance; and
- ***reinsurance function:*** responsible for the oversight and management of existing reinsurance contracts; and recommending the purchase of and overseeing the implementation and performance of future reinsurance contracts.

Solvency II

The Group has an established Group-wide Solvency II programme with the aim of ensuring that the Group implements the required changes in a timely and appropriate manner, including achieving internal model approval for U K Insurance, its main UK regulated insurance entity. Changes required to bring the Group into full compliance with Solvency II remain ongoing and in the period prior to implementation of Solvency II, the Group intends to further develop its internal model, both in terms of scope and area of use. Finalisation of the internal model, all associated processes including data quality, and independent validation are necessary for regulatory approval. Delay to any of these or any other aspects of the programme could result in less time for live running of the model and increase the risk of not achieving timely internal model approval for U K Insurance.

In addition to an enhanced risk based assessment of the capital requirement, the programme is intended to drive improved risk management by ensuring risk and capital effects are consistently taken into consideration in strategic and operational decision making. The range and nature of items requiring regular review and approval by the Board or the Board Risk Committee in relation to the internal model will also increase, such as the need to review and approve the Group's own risk and solvency assessment.

INTELLECTUAL PROPERTY

The Group is the owner of, amongst others, trade marks for Churchill, Direct Line, Privilege, and Green Flag. These trade marks are established, registered and well known in the United Kingdom through their extensive use and are therefore key to the success and strength of the Group's brands. The trade marks Direct Line and Green Flag are also registered and in use in Germany and Italy. The Group has obtained Community Trade Marks registrations for, amongst others, the Direct Line, Churchill and Green Flag trade marks. In certain other territories outside the United Kingdom and European Union, trade marks have been registered, or applications have been filed. These registrations and applications have been made in territories where the Group may want to establish business under one of its existing brands in the future. The Group is diligent in protecting its trade marks. The Group is the owner of the websites at, amongst others, "churchill.com", "directline.com", "directlineforbusiness.co.uk", "privilege.com" and "greenflag.com", and a total of 684 domain names will be transferred to the Group as part of the separation process.

INFORMATION TECHNOLOGY

The Group's UK Business Technology Services ("**BTS**") function shapes, builds, runs and governs the information technology ("**IT**") for the Group's UK operations. The BTS function is organised into six functions: strategy & architecture; solutions; delivery; infrastructure services; IT development & service delivery; and support office. The Group has also developed strategic supplier relationships with both HCL Technology Limited and Cap gemini, which provide additional application development and testing support.

The BTS function oversees the Group's UK insurance IT application portfolio and develops a majority of the application designs, code and support, including configuration management, release, implementation and testing. Under the terms of the TSA, RBS Group technology services provides the data centre services and builds and supports the Group's IT infrastructure including servers, networks, desktops and telephony. The majority of the services and supporting infrastructure that the RBS Group will provide are independent of other RBS Group systems. The Group's customer facing operations are already largely separate from the RBS Group. In addition, the Group runs and services separate IT systems for its Italian and German businesses (and for which the RBS Group also provides certain IT infrastructure services under the TSA), leveraging the knowledge and experience of its UK operations and BTS function.

The Group manages and owns the applications that cover the sales and service processes, internet back end processing, customer documents, pricing and underwriting, claims, complaints, accounting and management information for most of its products, and is currently in the process of improving the capabilities of many of these platforms, particularly for claims handling, pricing and rating. The Group is also making investments in IT infrastructure, such as an upgrade to its desktop and UK call centre technology, which the Group believes will enable more sophisticated call routing, integrated telephony management and improvements to its information security processes. The Group has recently implemented new systems to enable separation of human resources, financial reporting and procurement.

During the TSA period, the Group will continue to rely on the RBS Group for the provision of data centre services and certain other IT infrastructure services under the terms of the TSA (See Part XVI: "*Additional Information—Material Contracts—Transitional Services Agreement*" for a summary of the terms of the TSA). The Group is currently intending to identify third-party suppliers to which these data centres and other IT infrastructure services would migrate by the end of the TSA period. The Group will be making a significant investment in its own IT both to prepare for and execute that migration, and expects to incur one-off costs in the region of £100 million, before any applicable tax deduction, approximately in roughly similar amounts over 2013 and 2014. This amount does not include additional operating costs to be incurred under the TSA or other capital expenditure in relation to IT in the ordinary course of the Board's investment plans for the Group. Following migration and the end of the TSA period, the Group currently expects ongoing run-rate costs for network and hosting infrastructure to be broadly in line with annual TSA expenditures.

RUN-OFF BUSINESSES

The Group has two businesses remaining within its run-off activities. These businesses consist of policies written through the TPF partnership arrangement and NIG personal lines business sold via brokers. In both cases, no new policies have been written since October 2010, save for TPF credit card PPI policies, which the Group continued to renew on a monthly basis until June 2012 when those policies were migrated to Tesco's new provider.

The table below provides certain information with respect to the Group's run-off businesses as at and for each of the years ended 31 December 2011, 2010, and 2009 and the six months ended 30 June 2012 and 2011:

	Six months ended 30 June 2012	Six months ended 30 June (unaudited) 2011	Year ended 31 December 2011	2010	2009[1]
	(millions, £ except policies)				
Gross written premiums	4.1	26.1	43.4	875.7	1,119.5
Operating profit (loss)	1.2	(12.4)	(23.9)	(140.7)	(165.1)
In-force policies	0.0	1.3	0.0	2.4	3.0

(1) Includes Linea Directa, which the Group sold to Bankinter during 2009. See "*—History of the Business—Development of the Group*".

Tesco Personal Finance

In 1999, the RBS Group entered into a 50:50 joint venture with Tesco called Tesco Personal Finance Limited, pursuant to which the Group underwrote a range of general and life insurance products under the Tesco brand for Tesco Customers (the "**TPF Policies**"). In December 2008, the RBS Group sold its share in TPF to Tesco.

At the time of the sale, the Group terminated the existing insurance distribution agreements and entered into new agreements (one for general insurance business and one for life insurance business) under which it underwrote, sold and administered the TPF Policies and provided certain related insurance services to TPF for a period of approximately two years. Pursuant to those distribution agreements, the Group agreed to provide, after the initial two-year period, ongoing claims and administration services relating to in-force TPF policies for a further two year run-off period, which, under the terms of those agreements, was scheduled to expire in October 2012.

The Group has recently agreed with TPF the level of final reserves to be retained by it in respect of the run off of remaining claims under TPF Policies and finalised certain other matters arising out of the expiration of the distribution arrangements. The determination process concluded that there was a reserves surplus in relation to the TPF Policies, the benefit of which will flow to TPF. The Group will continue to administer the TPF Policies and remain exposed to the risks under those policies. The agreement with TPF is not expected to be material in the context of the overall Group financial performance.

In 2006, TPF provided the Group with £255.0 million of solvency capital which appears in the Group's tier 2 capital as a perpetual subordinated loan (the "**TPF Note**"). At the same time, TPF provided the Group with £3.5 million of solvency capital on similar terms in relation to the TPF life insurance business,

which also appears in the Group's tier 2 capital and can be withdrawn at TPF's request. Following the recent determination of the reserves, the Group intends, subject to the consent of the FSA, to repay the £258.5 million of capital provided by TPF, although currently this is not expected to happen until 2013. See also "*—Capital Resources—Capital management policy*".

Personal lines business sold via brokers

The Group previously sold a range of personal lines insurance policies, namely personal lines motor, home, pet and travel insurance polices through brokers under its NIG brand. This business was put into run off in the fourth quarter of 2010, such that all policies expired by the end of 2011. The Group will continue to manage the claims arising from this business to final settlement, which it expects could take several years in the case of certain high severity personal injury claims under the motor account.

PART VIII—DIRECTORS, SENIOR MANAGEMENT AND CORPORATE GOVERNANCE

1. Directors, Senior Management and Employees

1.1 Directors

The current members of the Board are:

Name	Position	Date of Birth
Michael Nicholas Biggs	Chairman	14/08/52
Paul Robert Geddes	Chief Executive Officer	04/06/69
Anthony Jonathan Reizenstein	Finance Director	24/06/56
Glyn Parry Jones	Senior Independent Non-Executive Director	17/03/52
Andrew William Palmer	Independent Non-Executive Director	14/10/53
Jane Carolyn Hanson	Independent Non-Executive Director	22/09/67
Clare Eleanor Thompson	Independent Non-Executive Director	13/11/54
Priscilla Audrey Vacassin	Independent Non-Executive Director	20/04/57
Bruce Winfield Van Saun	Non-Executive Director	30/05/57
Mark Catton	Non-Executive Director	19/05/66

Michael Nicholas Biggs—Chairman

Mike joined the Board and became Chairman of the Group in April 2012. Mike has almost 40 years of experience in the UK and international financial services sector. He is chairman of Resolution Limited, the FTSE 100 UK life assurance business, and has previously acted as chief executive officer and group finance director of Resolution plc and group finance director of Aviva plc. Mike was a key member of the senior management team that demutualised and subsequently floated Norwich Union on the London Stock Exchange in 1997, and merged Norwich Union with Commercial General Union to create CGNU in 2000.

Paul Robert Geddes—Chief Executive Officer

Paul was appointed as Chief Executive Officer of the Group in August 2009. Prior to his move to the Company, Paul was the chief executive officer of the RBS Group's mainland UK retail banking business, having joined that business in 2004 as managing director with responsibility for products and marketing. Before joining the RBS Group, Paul held a number of senior roles in multi-channel retailing in businesses then forming part of the GUS and Kingfisher groups. Paul started his career in marketing with Procter & Gamble in UK and European roles. Paul read politics, philosophy and economics at Oxford. He is a fellow of the Chartered Institute of Bankers in Scotland, a member of the ABI Board, a member of the Financial Ombudsman Service's insurance industry steering group and a member of the FSA Practitioner Panel.

Anthony Jonathan Reizenstein—Chief Financial Officer

John joined as Chief Financial Officer in December 2010. He was previously managing director, corporate and markets at Co-operative Banking Group (CBG, the group bringing together The Co-operative Bank, Co-operative Insurance Society and CIS General Insurance) and finance director at CBG from 2003 to 2007. Prior to joining CBG, John spent more than 20 years in investment banking, with UBS and subsequently with Goldman Sachs. John is an economics graduate from Cambridge University.

Glyn Parry Jones—Senior Independent Non-Executive Director

Glyn joined the Board in September 2012. Glyn is chairman of Aspen Insurance Holdings Limited, a New York listed specialty lines insurance and re-insurance business; he became the chair in May 2007. He is also chairman of Aspen Insurance UK Limited, a principal operating subsidiary of the Aspen Group. Glyn was formerly the chairman of Towry Holdings Limited between 2006 and 2011. He also served as chairman of Hermes Fund Managers from 2008 to 2011 and was chairman of the sister company BT Pension Scheme Management for a part of this period. Glyn was chief executive officer of the independent investment group, Thames River Capital, from 2005 to 2006. From 2000, he served as chief executive officer of Gartmore Investment Management in the United Kingdom for four years. Before this, Glyn was chief executive officer of Coutts NatWest Group and Coutts Group, having

joined in 1997. In 1991, Glyn joined Standard Chartered in Hong Kong where he became the general manager of Global Private Banking. He was a consulting partner with Coopers & Lybrand/Deloitte Haskins & Sells Management Consultants from 1981 to 1990. Glyn is a graduate of Cambridge University and a Fellow of the Institute of Chartered Accountants in England & Wales.

Andrew William Palmer—Independent Non-Executive Director

Andrew joined the Board in March 2011. Andrew is the senior independent director at Segro plc, the British and European Industrial REIT Company; a trustee of the Royal School of Needlework and a non-executive director of RSN Enterprises Limited; and a non-executive director at Royal London Mutual Insurance Society Limited. He will be stepping down as senior independent director at Segro plc in April 2013. In 2009 he retired from Legal & General Group plc, where he was the group finance director. He is a member of The Financial Reporting Review Panel, of the Financial Reporting Council. Andrew is a Fellow of the Institute of Chartered Accountants in England & Wales.

Jane Carolyn Hanson—Independent Non-Executive Director

Jane joined the Board in December 2011. A Fellow of the Institute of Chartered Accountants in England and Wales, Jane qualified with KPMG, where she spent over 12 years working in the financial sector becoming director responsible for the delivery of corporate governance, internal audit and risk management services in the North of England. Jane has also held executive roles as director of audit, and risk and governance director at Aviva's UK Life business. Jane is chair of the Audit and Risk Committee and non-executive director at Reclaim Fund Ltd; an independent member of the fairness committee at ReAssure Ltd; and chair of the Audit Committee and senior independent director at Calderdale and Huddersfield Foundation Trust. Jane has her own financial sector consulting business, delivering audit, enterprise risk management and corporate governance advisory and consulting services and is also a magistrate. Jane is a graduate of York University with a degree in music.

Clare Eleanor Thompson—Independent Non-Executive Director

Clare joined the Board in September 2012. A Fellow of the Institute of Chartered Accountants in England and Wales, Clare became a Partner at PricewaterhouseCoopers ("**PwC**") in 1988. Whilst Clare was at PwC, she held several senior and high profile roles, particularly within the insurance sector and retired after 23 years as a Partner in 2011. Clare is presently a non-executive director on the Partnership Board of Miller Insurance Services LLP. She is also a non-executive director at Autistica and the Disasters Emergency Committee.

Priscilla Audrey Vacassin—Independent Non-Executive Director

Priscilla joined the Board in September 2012. She was most recently Group Human Resources Director at Prudential plc and member of the Audit Committee at the Ministry of Defence. Priscilla has previously held senior human resources positions across a number of financial services and customer facing industries including roles at Abbey National plc, where she was Executive Director, Human Resources; BAA plc, where she was Group Human Resources Director and Kingfisher plc.

Bruce Winfield Van Saun—Non-Executive Director

Bruce joined the Board in April 2012. Bruce is also Group Finance Director of RBS and a member of the RBS group board and its executive committee. Bruce has over 25 years of financial services experience. From 1997 to 2008 he held a number of senior positions with Bank of New York and later Bank of New York Mellon, most recently as vice-chairman and chief financial officer and before that he was responsible for asset management and market related businesses. Previously he held senior positions with Deutsche Bank, Wasserstein Perella Group and Kidder Peabody & Co. He has served on several corporate boards as a non-executive director and has been active in numerous community organisations.

Mark Catton—Non-Executive Director

Mark joined the Board in September 2012. Mark sits on the Royal Bank of Scotland Group management committee and is chief executive officer of UK Corporate and Institutional Banking at RBS, a position he has held since 2008. Mark rejoined the RBS Group in August 2007 as a managing director in corporate banking, having previously worked for NatWest. Prior to joining the RBS Group,

Mark was a senior executive at Barclays from 2001 to 2007, responsible for a number of its clients and product businesses, and in the latter period as managing director in European investment banking and debt capital markets at Barclays Capital. Mark is an associate of the Chartered Institute of Bankers and Association of Corporate Treasurers.

1.2 Senior Management

In addition to the Executive Directors, the current members of the senior executive management team with responsibility for day-to-day management of the Group's business are:

Jonathan Alastair Davidson—Chief Operating Officer

Jonathan joined as Chief Operating Officer in January 2010. Previously, he spent over 20 years at McKinsey & Co becoming a Director and playing leadership roles in the firm's financial services and organisation practices in the UK and North America where his special focus was on programmatic transformation. Jonathan holds a degree in Engineering and Economics from Oxford University and an MBA from the Harvard Business School.

Thomas Woolgrove—Managing Director, Personal Lines

Tom joined as Managing Director, Personal Lines in April 2010, responsible for all Retail product categories and brands. Previously, he held various Managing Director roles with HBOS and Lloyds Banking Group, including UK Private Banking, General Insurance and Motor Finance. Tom was formerly a strategy consultant with Gemini Consulting, part of the Cap Gemini Group, and a graduate engineer with Rolls Royce Aerospace. He is a member of the Association of British Insurers General Insurance Committee and the Chartered Insurance Institute Professionalism Taskforce. He was elected Deputy President of the Chartered Insurance Institute in July 2012. Tom holds a Masters Degree in Engineering and Management from Oxford University, and an MBA from the University of Chicago Booth School of Business.

Steven Maddock—Managing Director, Claims

Steven joined as Managing Director of Claims in February 2010. Previously, Steven held the position of Director of Strategic and Technical Claims at RSA, a role he held since 2004. He has over 20 years' insurance industry experience including previous roles as Director of Claims and Customer Service at Capita and Director of Operations at AMP. Steven holds an MBA from the University of Reading and is a non-executive director of the Motor Insurers' Bureau and the Insurance Fraud Bureau.

Darrell Paul Evans—Managing Director, Sales, Services and Partnerships

Darrell joined as Managing Director, Sales, Service and Partnerships in October 2009. Previously he was Director of Products at the RBS Group before assuming responsibility for all mortgage brands and the retail telephony centres in the retail bank at RBS Group. Darrell began his career with the RBS Group when he joined NatWest in 1986 where he undertook a variety of strategy, finance, marketing and product management roles. Darrell holds an MBA from the Aston Business School.

Jonathan Paul Greenwood—Managing Director, Commercial

Jonathan joined in 2001 and has held various senior positions in Personal Lines, Partnerships and Commercial Divisions including Product and Pricing Director for UKI Partnerships, providing personal lines products to affinity partners including Tesco Personal Finance, Vauxhall, BMW and Nationwide Building Society. Following the Group's acquisition of Churchill, Jonathan became Commercial Director and then Managing Director for Household and non-Motor business incorporating Direct Line, Churchill and Partner and Broker distribution. In 2009 Jonathan took over as Managing Director Commercial which includes the brands NIG, Direct Line for Business (DL4B) and UK Insurance Business Solutions. Previously, Jonathan was Vice President of Insurance for MBNA Europe where he was responsible for managing insurance products and operations and prior to this he was General Manager and a founding member of Commercial Union Creditor, a specialist joint venture formed between Commercial Union and a UK division of BNP Paribas. Jonathan started his career in General Insurance at Halifax later HBOS where he held a variety of senior product and operational roles in the general insurance division.

James Chalmers Brown—Managing Director, International

Jamie joined in 1997 as part of the Motor team, initially setting up Direct Line Rescue (the Group's UK Road Assistance Business) and in 1999 he was responsible for the acquisition and integration of Green Flag. In 2001 he moved to Italy to lead the development of the Direct Line business in that market and in 2008 took broader responsibility across the Group's other European businesses. In 2009 Jamie was responsible for the sale of the Group's Spanish business, Linea Directa. In 2011 Jamie was appointed Managing Director International. Previously Jamie followed a career both inside and outside the insurance industry in the UK and overseas. He is a Chartered Accountant and has spent six years in the accountancy profession, 23 years in the insurance industry with AIG, Churchill and Direct Line and six years in other industries.

Humphrey Michael Tomlinson—General Counsel and Company Secretary

Humphrey has more than 20 years' experience since qualifying as a solicitor in 1989, and has advised on corporate and commercial matters, legal risk management and corporate governance issues, with RSA Insurance Group (formerly Royal & Sun Alliance), where he was Group Legal Director, and prior to RSA with City law firm Ashurst Morris Crisp. His experience includes a wide range of transactions involving many countries, including stock exchange listings (such as the IPO of RSA's Australian and New Zealand operations), mergers and acquisitions, joint ventures and disposals (such as the disposal of RSA's UK life insurance operations). He is a graduate of Oxford University.

Jose Rafael Vazquez—Chief Risk Officer

Jose joined as Chief Risk Officer in March 2012. Previously he was Global Chief Risk Officer at HSBC Insurance, where he had responsibility for the Group Chief Actuary, and was a board member of its captive insurance company. While at HSBC Jose established and embedded a global risk framework and capability. Prior to joining HSBC, Jose held various roles over ten years at Zurich Insurance, initially in London Market Operations, subsequently as Chief Actuary International Business Division (Asia, Latin America and Africa) and finally as Chief Actuary of the UK, where he played a key role in the transfer of all of Zurich UK's liabilities to Ireland under Part VII of FSMA. Jose started his career as a consulting actuary, which included six years as a consultant with KPMG in London where he worked on a wide range of domestic and European engagements. Jose is a maths graduate from Brunel University and a Fellow of the Institute of Actuaries.

Mark Terry Martin—Human Resources Director

Mark joined as Human Resources Director in February 2010. Previously he was Human Resources Director and a member of the Board at T-Mobile Limited. Prior to T-Mobile Limited, Mark held a number of human resources, general management and marketing roles in food manufacturing, fast moving consumer goods, telecoms and the public sector. He holds a BSC (Honours) degree in Management and Personnel Practice from Aston University, and is a Fellow and Graduate of the Chartered Institute of Personnel and Development.

Sheree Kim Howard—Managing Director Solvency II and Executive Projects

Sheree joined NIG as a Motor Manager (Pricing and Actuarial) in 1997 becoming Group Actuary when Churchill acquired NIG in 2001. Since the Group's acquisition of Churchill in 2003, Sheree has held various roles including Director of Actuarial Services and Director of Pricing and Underwriting, eventually becoming Chief Risk Officer in August 2009 where she was responsible for enhancing the risk function, developing and launching the risk appetite and risk frameworks and building the Group's risk model for Solvency II. In March 2012 Sheree was appointed Managing Director, Solvency II and Executive Projects where she continues to be responsible for the implementation of Solvency II and its embedding across the organisation, jointly developing the risk framework governing the Group's separation and divestment from the RBS Group and other executive level initiatives. Sheree started her career at Sun Alliance where she was a graduate actuarial trainee and following qualification as an actuary she moved to the role of Product Actuary (Life). Subsequently Sheree joined Zurich Municipal as an Assistant Actuary in its commercial division with responsibility for reserving and assisting with the pricing of large commercial risks. Sheree is a graduate of Warwick University where she gained a Bachelor of Science (Honours) in Mathematics and of City University where she gained an Actuarial Science Diploma (Distinction). Sheree is a Fellow of the Institute of

Actuaries and a Member of the following committees: Enterprise Risk Management Practice Executive Committee and General Insurance Professional Standards Committee.

Robert Clement Bailhache—Director of Communications

Robert joined the Group as Director of Communications in February 2012. He has 19 years' experience in international capital markets as a communications specialist and financial journalist. Robert was previously a Managing Director and Head of Group Press Office at HSBC Holdings. Prior to this he was Managing Director, Financial Services and a Partner of Financial Dynamics, a subsidiary of FTI Consulting Inc. Robert began his career in business media where he held senior journalist roles in the UK and Asia. He received three nominations at the World Leadership Forum's 2003 Business Journalist of the Year awards and was shortlisted as Financial Journalist of the Year at the 2001 British Press Awards. Robert is a graduate of the University of Nottingham where he gained a Bachelor of Arts (Honours) in Politics and the University of London where he gained a Master of Arts in South Asia Studies. He holds a Certificate in Investor Relations awarded by The Investor Relations Society.

1.3 Employees

The table below sets out the average number of people (full time equivalents) employed by the Group in the previous three financial years:

	Year ended 31 December		
Average number of persons employed	**2011 Number**	**2010 Number**	**2009 Number**
Operations	14,765	15,810	16,503
Support	1,552	1,272	1,357
Total	**16,317**	**17,082**	**17,860**

2. Corporate Governance

The UK Corporate Governance Code published by the Financial Reporting Council in June 2010 (the "**UK Corporate Governance Code**") provides that the board of directors of a company with a premium listing should include a balance of executive and non-executive directors (and in particular independent non-executive directors), with independent non-executive directors (excluding the Chairman) comprising at least one-half of the board. The UK Corporate Governance Code states that the board should determine whether a director is independent in character and judgement and whether there are any relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement.

The Directors support high standards of corporate governance. As at the date of this Prospectus and on Admission, the Group will comply with the UK Corporate Governance Code. The Company's Board of Directors currently comprises two Executive Directors (including the Chief Executive Officer) and eight Non-Executive Directors (including the Chairman). The Company regards Andrew Palmer, Jane Hanson, Clare Thompson, Priscilla Vacassin and Glyn Jones as independent Non-Executive Directors, within the meaning of "independent" as defined in the UK Corporate Governance Code.

The UK Corporate Governance Code recommends that the board should appoint one of its independent non-executive directors to be the senior independent director (the "**SID**"). The SID should be available to shareholders if they have concerns that the normal channels of Chairman, Chief Executive Officer or other executive directors have failed to resolve or for which such channel of communication is inappropriate. The Company's SID is Glyn Jones.

3. Audit, Remuneration, Nomination and Board Risk Committees

As envisaged by the UK Corporate Governance Code, the Board has established Audit, Remuneration, Nomination and a Board Risk Committee, as well as a Board Risk Committee. During the recent past, the Board had a combined Risk and Audit Committee. In addition, the Board has established a Corporate Social Responsibility committee and a Disclosure Committee. The UK Corporate Governance Code requires that the Audit Committee and Remuneration Committee

should each have at least three independent non-executive directors and that, in the case of the Nominations Committee, a majority of the members should be independent non-executive directors.

3.1 Audit Committee

In accordance with the requirements of the UK Corporate Governance Code, the Audit Committee is made up of at least three members who are all independent non-executive directors and includes one member with recent and relevant financial experience and the Chairman of the Board Risk Committee. The Audit Committee is chaired by Andrew William Palmer, an independent non-executive director. The Audit Committee will normally meet at least four times a year at the appropriate times in the reporting and audit cycle. The committee has responsibility for, amongst other things, the monitoring of the financial integrity of the financial statements of the Group and the involvement of the Group's auditors in that process. It focuses in particular on compliance with accounting policies and ensuring that an effective system of internal financial control is maintained. The ultimate responsibility for reviewing and approving the annual report and accounts and the half-yearly reports, remains with the Board.

The terms of reference of the Audit Committee cover such issues as membership and the frequency of meetings, as mentioned above, together with requirements of any quorum for and the right to attend meetings. The duties of the Audit Committee covered in the terms of reference are: financial reporting, internal controls, internal audit, external audit and reserving. The terms of reference also set out the authority of the committee to carry out its duties.

3.2 Remuneration Committee

In accordance with the requirements of the UK Corporate Governance Code, the Remuneration Committee is made up of at least three members who are all independent non-executive directors. The Remuneration Committee is chaired by Priscilla Audrey Vacassin, an independent non-executive director. The Remuneration Committee, which meets at least four times a year, has responsibility for the determination of specific remuneration packages for each of the Executive Directors and certain senior executives of the Group, including pension rights and any compensation payments and recommending and monitoring the level and structure of remuneration for senior management, and the implementation of share option, or other performance-related, schemes.

The terms of reference of the Remuneration Committee cover such issues as membership and frequency of meetings, as mentioned above, together with the requirements for quorum for and the right to attend meetings. The duties of the Remuneration Committee covered in the terms of reference relate to the following: determining and monitoring policy on and setting level of remuneration, early termination, performance-related pay, pension arrangements, authorising claims for expenses from the Chief Executive Officer and Chairman, reporting and disclosure, share schemes and remuneration consultants. The terms of reference also set out the reporting responsibilities and the authority of the committee to carry out its duties.

3.3 Nomination Committee

In accordance with the requirements of the UK Corporate Governance Code, the Nomination Committee is made up of at least three members who are all independent non-executive directors. The Nomination Committee is chaired by Michael Biggs, the Chairman of the Company. The Nomination Committee meets at least twice a year at appropriate times in the reporting cycle.

The Nomination Committee is responsible for considering and making recommendations to the Board in respect of appointments to the Board, the Board Committees and the chairmanship of the Board Committees. It is also responsible for keeping the structure, size and composition of the Board under regular review, and for making recommendations to the Board with regard to any changes necessary. The Nomination Committee also considers succession planning, taking into account the skills and expertise that will be needed on the Board in the future.

3.4 Board Risk Committee

The Board Risk Committee is responsible for providing oversight and advice to the Board in relation to current and potential future risk exposures of the Group and future risk strategy, reviewing and

approving various formal reporting requirements and promoting a risk awareness culture within the Group.

The Board Risk Committee is made up of at least three members who are all independent non-executive directors, one of whom is the Chairman of the Audit Committee and is chaired by Jane Hanson, a non-executive director. The Chief Financial Officer, Chief Risk Officer, Chief Executive Officer, Head of Internal Audit and the General Counsel & Company Secretary shall be regular attendees. The Board Risk Committee will normally meet at least four times a year at appropriate times in the regulatory and financial reporting cycle.

The terms of reference of the Board Risk Committee cover such issues as membership and frequency of meetings, as mentioned above, together with the requirements for quorum for and right to attend meetings. The principal duties of the Board Risk Committee covered in the terms of reference are in relation to: risk strategy and policy, risk profile, risk appetite, risk management operating model, risk architecture, whistleblowing and fraud, elements of remuneration in the context of risk that may give rise to undue incentivisation to take risk, supervision of the risk management committee and the Chief Risk Officer. The terms of reference also set out the authority of the committee to carry out its duties.

3.5 Corporate Social Responsibility Committee

The Corporate Social Responsibility Committee is made up of two non-executive directors, the Chief Executive Officer and one member of the Executive Committee and is chaired by Jane Hanson, a non-executive director. The Corporate Social Responsibility Committee will normally meet at least four times a year.

The Corporate Social Responsibility Committee is responsible for ensuring the Group conducts its business in a responsible manner (including in relation to environmental, corporate social responsibility, social and ethical matters). The Committee also oversees the monitoring of charitable donations and community involvement.

The terms of reference of the Corporate Social Responsibility Committee cover such issues as membership and frequency of meetings, as mentioned above, together with the requirements for a quorum for and right to attend meetings. The duties of the Corporate Social Responsibility Committee covered in the terms of reference are in relation to the review of the Group's overall sustainability strategy and policies. The terms of reference also set out the authority of the committee to carry out its duties.

3.6 Disclosure Committee

The Disclosure Committee is made up of the Chief Executive Officer, the Chief Financial Officer, the General Counsel & Company Secretary, Head of Investor Relations and the Director of Communications and is chaired by the Chief Executive Officer, failing whom the Chief Financial Officer, failing whom the General Counsel & Company Secretary. The Disclosure Committee will normally meet at least four times a year at appropriate times in the reporting cycles and otherwise, as required.

The Disclosure Committee is responsible for monitoring, evaluating and enhancing disclosure controls and procedures of the Group.

The terms of reference of the Disclosure Committee cover such issues as membership and frequency of meetings, as mentioned above, together with the requirements for a quorum for and right to attend meetings. The duties of the Disclosure Committee covered in the terms of reference are in relation to financial reporting and other material disclosures. The terms of reference also set out the authority of the committee to carry out its duties.

4. Takeover Regulation

The City Code on Takeovers and Mergers (the "**City Code**") is issued and administered by The Panel on Takeovers and Mergers (the "**Takeover Panel**"). The Company is subject to the City Code and therefore its Shareholders are entitled to the protections afforded by the City Code.

Under Rule 9 of the City Code when (i) a person acquires an interest in shares which (taken together with shares he and persons acting in concert with him are interested) carry 30% or more of the voting rights of a company subject to the City Code, or (ii) any person who, together with persons acting in

concert with him, is interested in shares which in the aggregate carry not less than 30% of the voting rights of a company, but does not hold shares carrying more than 50% of the voting rights of the company subject to the City Code, and such person, or any persons acting in concert with him, acquires an interest in any other shares which increases the percentage of the shares carrying voting rights in which he is interested, then, in either case, that person, together with the person acting in concert with him, is normally required to extend offers in cash, at the highest price paid by him (or any persons acting in concert with him) for shares in the company within the preceding 12 months, to the holders of any class of equity share capital whether voting or non-voting and also to the holders of any other class of transferable securities carrying voting rights.

Following Admission, the Selling Shareholder will hold between approximately 75.0% and 66.7% of the voting rights attached to the issued share capital of the Company, assuming the Over-allotment Option is not exercised, and between approximately 71.3% and 61.7% assuming the Over-allotment Option is exercised in full. Investors should be aware that any person who acquires 30% or more of the voting rights attached to the issued share capital of the Selling Shareholder may, pursuant to Note 8 to Rule 9.1 of the City Code, be required by the Takeover Panel to make an offer for the shares in the Company not owned or controlled by the Selling Shareholder at that time.

The Group's insurance subsidiaries in the United Kingdom, Germany and Italy are subject to detailed and comprehensive legislation and regulation in each jurisdiction. Regulatory agencies have broad administrative powers over many aspects of the insurance business, which may include marketing and selling practices, advertising, licensing agents, product development structures, premium rates, policy forms, claims and complaint handling practices, data and records management, systems and controls, controlled function holders, capital adequacy, and permitted investments.

The Group is subject to regulation and supervision by the FSA in relation to the carrying on of its regulated activities in the United Kingdom. In respect of its international operations, Direct Line Insurance S.p.A. ("**Direct Line Italy**") is subject to regulation and supervision by ISVAP and Direct Line Versicherung AG ("**Direct Line Germany**") is subject to regulation and supervision by BaFin. All countries in which the Group carries out insurance business have implemented the EU directives concerning the taking up and pursuit of non-life insurance business. As a result, all of the Group's regulated entities are subject to capital requirements with a view to ensuring the protection of policyholders.

The following discussion considers the main features of the UK, Italian and German regulatory regimes for insurance business as it applies to the Group's authorised insurance companies in the United Kingdom, Direct Line Italy and Direct Line Germany, respectively.

Regulation in the United Kingdom

The FSA's powers

In the United Kingdom, the Group's business is currently subject to primary regulation by the FSA, which has broad powers under the FSMA, including, among others, the authority to: grant and, in specific circumstances, to vary or cancel permissions; ensure regulated firms treat customers fairly; investigate marketing, sales, claims and complaint handling practices; and require the maintenance of adequate financial resources. One of the FSA's principal regulatory objectives in the context of the regulation of insurance companies is the protection of policyholders and third-party claimants, rather than shareholders or general creditors.

The FSA has powers to impose requirements on an insurance company (such as a requirement not to take on new business) if it is satisfied that the company has not met its capital adequacy requirement or does not meet the Threshold Conditions (as defined below in "*—Permission to carry on insurance business*"). The FSA may make enquiries or conduct inspections of the companies which it regulates regarding compliance with regulations governing the conduct and operation of business. Issues and disputes may arise from time to time in relation to the way an insurance product has been constructed, sold or administered, or in the way in which policyholders or customers have been treated, either at an individual firm level or across the insurance industry. In the United Kingdom, individual policyholder disputes of this nature are typically resolved by the Financial Ombudsman Service or by litigation. The FSA may intervene directly, however, where larger groups or matters of public policy are involved. There have been several industry-wide issues in recent years where the FSA intervened directly, such as the sale of payment protection insurance.

The FSA has wide powers to supervise and intervene in the affairs of an insurance company, for example, if it considers that it is appropriate in order to protect policyholders or potential policyholders against the risk that the company may be unable to meet its liabilities as they fall due, that the Threshold Conditions may not be met, that the company or its parent has failed to comply with obligations under the relevant legislation, that the company has furnished misleading or inaccurate information or that there has been a substantial departure from any proposal or forecast submitted to the FSA. The FSA also has the power to take a range of informal and formal disciplinary or enforcement actions in relation to a breach by a firm of FSMA or the rules in the FSA's Handbook, including private censure, public censure, restitution, fines or sanctions and the award of compensation. The FSA may also cancel or vary (including by imposing limitations on) a Part IV Permission (as defined below in "*—Permission to carry on insurance business*") of an insurance company, including cancelling permission to write new policies, thereby putting the insurer into run-off.

Permission to carry on insurance business

Under section 19 of the FSMA, it is unlawful to carry on insurance business in the United Kingdom without permission to do so from the FSA under Part IV of the FSMA (a "**Part IV Permission**").

The FSA, in deciding whether to grant a Part IV Permission, is required to determine whether the applicant satisfies, and will continue to satisfy, the FSMA Threshold Conditions (the "**Threshold Conditions**"). As part of this decision, the FSA will consider whether the applicant has adequate resources and if the applicant is 'fit and proper' to be authorised (that is, whether it has established systems and controls to comply with regulatory standards and the FSA's Principles for Business, which cover matters such as: integrity; skill, due care and diligence; management and control; financial prudence; observance of the proper standards of market conduct; payment of due regard to customers' interests and treating customers fairly; communication with clients; management of conflicts of interest; a proper relationship of trust with clients; adequate protection for clients' assets when responsible for them; and dealing with regulators in an open and cooperative way). A Part IV Permission will specify: (a) a description of the activities the firm can carry on, including any limitations to the scope of the permission; (b) the specified investments involved; and (c) if appropriate, any requirements imposed in relation to the Part IV Permission.

Once authorised, an insurance company is required to continue to meet the Threshold Conditions and comply with the FSA's Principles for Business. The FSA may impose limitations and requirements relating to the operation of an insurance company and the carrying on by it of insurance business through its Part IV Permissions.

Screening of controllers (including shareholders)

Under section 178 of FSMA, if a person intends to acquire or increase its "control" of an insurance company, it must first notify the FSA. The FSA must then decide whether to approve the acquisition or increase of control within 60 working days' of receipt of this notice (assuming it has been provided with a complete application). The FSA will not approve any new controller or any increase of control without being satisfied that the controller is financially sound and suitable to be a controller of, or acquire increased control of, the insurance company. Acquiring control for the purposes of FSMA includes where a person first holds 10% or more of the shares or voting power in an insurance company or its parent undertaking. A person will be treated as increasing his or her control over an insurance company, and therefore require further approval from the FSA, if the level of his or her shareholding or entitlement to voting power increases from a holding below certain thresholds to a holding above them. The thresholds are 10%, 20%, 30% or 50% of shares or voting power.

When determining a person's level of control, that person's holding of shares or entitlement to voting power will be aggregated with the holdings or entitlements of any person with whom he or she is "acting in concert".

Screening of controlled function holders

Certain key functions in the operation of an insurance business ("**controlled functions**") may only be carried out by persons who are approved for such tasks by the FSA under the FSMA ("**Approved Persons**").

Under FSMA, the FSA has powers to regulate two types of individuals: those whose functions have a significant influence on the conduct of an authorised company's affairs and functions and those who deal with customers (or the property of customers).

The 'significant influence' controlled functions include governing functions such as being a director or non-executive director of an insurance company, finance functions, actuarial functions and significant management functions, such as insurance underwriting. The FSA will not grant Approved Person status to an individual unless it is satisfied that the individual has appropriate qualifications and/or experience and is fit and proper to perform those functions.

Approved Persons must comply with the FSA's Fit and Proper Test for Approved Persons (as set out in the chapter of the FSA Handbook bearing such title) and the Statements of Principle and Code of Practice for Approved Persons (as set out in the chapter of the FSA Handbook bearing such title).

Prudential requirements

Detailed prudential rules applicable to carrying on insurance business are contained in the FSA's Handbook of Rules and Guidance (the "**FSA Handbook**"). The rules are set out in (i) its General Prudential Sourcebook ("**GENPRU**") and (ii) its Prudential Sourcebook for Insurers ("**INSPRU**"). The overall financial adequacy rule in GENPRU 1.2.26R requires an insurance company to maintain overall

financial resources, including capital resources and liquidity resources, which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.

(a) Capital requirements

GENPRU 2.1.13R provides that an insurer must maintain at all times capital resources equal to or in excess of its capital resources requirement (referred to as the "**CRR**"). The CRR for an insurance company carrying on general (and not long-term) insurance business is equal to the minimum capital requirement ("**MCR**") (GENPRU 2.1.17R). The MCR for an insurance company only carrying on general insurance business is the higher of:

(i) the base capital resources requirement; and

(ii) the general insurance capital requirement.

The base capital resources requirement is a euro-denominated amount specified in GENPRU 2.1.30R and the general insurance capital requirement is an amount determined by reference to a formula where the relevant inputs include the insurance company's premiums and claims and amounts brought forward from the previous year's capital requirement amount.

(b) Individual Capital Assessment

In addition to the CRR, insurance companies carrying on general insurance business are each required to calculate an enhanced capital requirement (the "**ECR**") under INSPRU 1.1.72B and carry out an Individual Capital Assessment ("**ICA**") under INSPRU 7. Pursuant to the ICA, insurance companies are required to conduct stress and scenario testing to determine the overall adequacy of their financial resources and make a reasonable assessment of the capital needs for their business overall in line with the overall financial adequacy rule in GENPRU 1.2.26R.

The ICA and the ECR assists the FSA to provide Individual Capital Guidance ("**ICG**") to insurance companies on a confidential basis. The ICG is set with reference to the specific business and control risks faced by each individual company and takes account of the company's ICA and any areas of prudence or optimism within the assessment or elsewhere in the business.

Reporting

Insurance companies are required to deposit with the FSA an annual return comprising audited accounts and other prescribed documents within three months of the end of the relevant financial year, if the deposit is made electronically, and otherwise within two months and fifteen days of the end of the relevant financial year. These returns are required to be prepared in accordance with the valuation rules in INSPRU and GENPRU and the reporting rules in the Interim Prudential Sourcebook for Insurers.

Investment of capital and reserves

Under INSPRU 1.1.20R, insurance companies carrying on general insurance business must hold admissible assets of a value at least equal to the amount of:

(A) the technical provisions that it is required to establish under INSPRU 1.1.12R, being, in essence, an estimate of the amount needed to cover expected insurance claims, adjusted for volatility and prudence; and

(B) its other general insurance liabilities.

Assets and investments only count towards capital adequacy requirements if they are permitted to be counted in accordance with the rules. Assets are also required to be deducted from capital resources if they do not comply with the requirements in INSPRU 2 as to counterparty and asset exposure limits (although they may still be included in the calculation of a firm's realistic assets). These limits are intended to prevent companies from having too much exposure to either one counterparty (including a group of companies) or one asset type.

Insurance group capital

The Directive on the Supplementary Supervision of Insurance Companies in an Insurance Group (1998/78/EC) (the "**Insurance Groups Directive**") as amended by the EU Directive on the Supplementary

Supervision of Credit Institutions, Insurance Undertakings and Investment Firms in a Financial Conglomerate (2002/87/EC) requires Member States to provide supervision for any insurance undertaking that is part of a group which includes at least one other insurance company, insurance holding company, reinsurance undertaking or non-member-country insurance undertaking. The relevant provisions governing group capital for UK insurers are primarily contained in Chapter 6 of INSPRU.

The Group is an insurance group for the purposes of the Insurance Groups Directive and is therefore subject to the supplementary supervisory requirements for insurance groups contained in that directive as implemented by the FSA as the regulator in the domicile of the Group's head office. The supplementary supervision of insurance groups encompasses such matters as intra-group transactions, group risk management processes and internal control processes and reporting and accounting procedures. In addition, in accordance with the Insurance Groups Directive, the FSA requires the calculation of group capital resources on a consolidated basis and requires that such group capital resources are equal to or in excess of the Group's capital resources requirement. These requirements apply at the same time as, and in addition to, the capital requirements which apply to U K Insurance and the other insurance companies within the Group on a solo basis.

Conduct of business requirements

The FSA's conduct of business requirements in relation to the distribution and sale of insurance products are contained in its Insurance Conduct of Business Sourcebook ("**ICOBS**").

ICOBS applies to non-investment insurance products, including long term non-investment insurance products such as mortgage protection insurance. These sourcebooks also implement the Insurance Mediation Directive (Directive 2002/92/EC) ("**IMD**") and extend the IMD to direct sales by insurers themselves.

Many of the provisions of these sourcebooks only apply to insurers or intermediaries who deal directly with retail customers, or are confined in their application to transactions with retail customers. Further, the rules require the product documentation to be fully compliant for retail sales.

Regulation in Italy

The ISVAP is an independent government regulator with powers similar to the FSA, including authority over financial, accounting, organisational and management aspects of insurance, among others. The supervision exerted by ISVAP is aimed to ensure the sound and prudent management of insurance and reinsurance undertakings as well as transparency and fair conduct by undertakings, intermediaries and other insurance sector participants, having regard to the stability, efficiency, competitiveness and correct functioning of the insurance system, the protection of policyholders and anyone entitled to insurance benefits, disclosure to and protection of consumers.

ISVAP carries out supervisory functions over, among others:

- undertakings pursuing insurance and reinsurance business within Italy;
- insurance groups and financial conglomerates to which the above undertakings belong, in accordance with the specific rules applicable to them (the so-called "supplementary" supervision);
- insurance and reinsurance intermediaries, loss adjusters and any other insurance market participant; and
- anyone who, in any form, performs functions partly included in the operational cycle of insurance and reinsurance undertakings, limited to insurance and reinsurance matters.

ISVAP carries out supervisory functions over the insurance sector by means of its powers of authorisation, direction, inspection, specific investigation and enforcement of precautionary measures and sanctions as well as through the adoption of any regulation necessary for the sound and prudent management of undertakings or for disclosure and fair conduct by supervised entities.

In particular, ISVAP grants insurers the authorisation to pursue insurance and/or reinsurance business in the different classes and to extend their activity to classes other than those already authorised, and performs all the tasks connected with the granting of authorisation, verifying over time that the conditions governing the business are being met. It also authorises mergers, divisions, portfolio transfers and intra-group transactions. These tasks are performed through checks of the technical, financial and accounting

management of the domestic and foreign insurance and reinsurance undertakings (branches of undertakings with their head office in a non-EU country) subject to its supervision.

ISVAP also plays a key role in consumer protection and seeks to ensure transparency between insurers and policyholders. ISVAP has the power *inter alia* to review and sanction the information that must be made available to policyholders, establishes the rules of conduct with which insurers and intermediaries must comply in the supply and execution of insurance contracts and monitors compliance with those requirements. According to Legislative Decree no. 58 of 24 February 1998, as amended ("**TUF**"), CONSOB carries out supervisory functions over financial-insurance products and intermediaries in the offering and distribution of such products.

On 15 August 2012, Law no. 135 of 7 August 2012 (so called Spending Review law) entered into force (Law 135). Law 135 has converted into law, with amendments, Legislative Decree no. 95 of 6 July 2012 ("**the Decree**"). Pursuant to Law 135, a new authority for the supervision of the insurance activity, called IVASS (Istituto per la Vigilanza sulle Assicurazioni), has been established. IVASS is an independent government regulator and will cooperate with the Bank of Italy in order to ensure full integration of the insurance and banking supervisory activities, in the context of the new European financial supervisory system.

In particular, on 7 July 2012 the corporate bodies of ISVAP lost their power and the president has been appointed as extraordinary commissioner for the ordinary and extraordinary activities of ISVAP.

At the entry into force of the IVASS by-laws (which shall be drafted by November 2012), ISVAP will be definitely abolished and IVASS will succeed in all ISVAP's powers, assets and liabilities. However, CONSOB will continue to carry out its supervisory activity over financial-insurance products and intermediaries, as provided by the TUF.

Regulation in Germany

The Federal Financial Services Supervisory Authority ("**BaFin**") supervises insurance and reinsurance undertakings and pension funds that have their registered office in Germany or carry out insurance business in Germany, insurance holding companies domiciled in Germany, and insurance groups and financial conglomerates, to which insurance and reinsurance undertakings domiciled in Germany belong. In addition, BaFin is in charge of regulating German branches of foreign insurance and reinsurance undertakings although, due to the European "home state regulator" principle, the BaFin's supervisory powers are somewhat limited (and do not include, for instance, any matters of financial supervision) if the relevant foreign insurance or reinsurance undertaking is domiciled in another EU/EEA jurisdiction.

The BaFin is an independent public-law institution under federal law and is subject to the legal and technical oversight of the Federal Ministry of Finance (*Bundesministerium der Finanzen*, the "**BMF**"). It is funded by fees and contributions from the insurance and reinsurance undertakings that it supervises.

The principal legal basis for BaFin's powers in the insurance sector is the Insurance Supervision Act (*Versicherungsaufsichtsgesetz*, the "**VAG**"). Pursuant to VAG, the two primary objectives of insurance supervision are to ensure that the interests of the insurance customers are adequately preserved and that the liabilities under insurance contracts will be fulfilled at all times. In order to implement Solvency II, draft amendments to the VAG have been introduced into the legislative process. The ultimate scope and content of the amendments as well as the relevant date of effectiveness are not clear, yet.

Insurance supervision by the BaFin is based on two main pillars. On the one hand, insurance business may not be carried out in Germany unless and until the undertaking has received an authorisation from the BaFin (apart from passporting rights of insurance and reinsurance undertakings domiciled in another EU/EEA state). On the other hand, the BaFin monitors all undertakings carrying out insurance or reinsurance business in Germany on an ongoing basis for compliance with the relevant laws.

Business activities of insurance undertakings are limited to defined classes of insurance business. Any authorisation to carry out insurance business is granted only upon evidence that the undertaking complies with statutory and regulatory provisions, in particular with respect to the minimum solvency requirements and the minimum requirements to risk management and good governance including the qualification and reliability of the members of the management board and the supervisory board.

In its ongoing supervision, the BaFin collects information (including changes relating to the business plan, information on the performance and standing of the respective undertaking, and others), evaluates it and observes the way in which the insurance undertakings conduct their business, in order to avoid undesirable

developments or to identify any such development in good time. The BaFin obtains key information via the insurance undertakings' external and internal financial reporting as well as extensive notification duties. At certain intervals or as required, BaFin also conducts reviews of an undertaking's situation by way of on-site inspections at the respective undertaking's offices. Moreover, transfers of insurance portfolios and any kind of transformation (*Umwandlung*) that involves insurance undertakings require prior authorisation by the BaFin. A company intending to hold at least 10% of the capital/voting rights in a German insurance undertaking must notify the BaFin, which is entitled to prohibit the acquisition within a period of 60 business days. An acquisition of a German insurance undertaking could, *inter alia*, be prohibited when evidence suggests that the acquirer's management is not trustworthy or the acquirer does not have the required "financial solidity". Moreover, the holder of such significant interest (or participation) shall immediately notify the BaFin of any intention to increase the amount of the interest (or participation) to the extent that the thresholds of 20%, 30% or 50% of the voting rights/nominal capital are reached or exceeded. Shareholders also have to notify BaFin of their intention to sell a significant participation.

The BaFin has various means of taking action against insurance undertakings. Under the rules of the VAG, the BaFin may issue any instructions that are appropriate and necessary in order to prevent or eliminate undesirable developments with respect to insurance undertakings—in particular the failure to comply with the statutory and regulatory requirements—that threaten to harm the interests of the insurance customers. In addition, the VAG confers a number of special powers to the BaFin in order to avert certain typical threats to the functioning of an insurance undertaking, such as the power to appoint a special commissioner to replace the management board or the supervisory board of the company. The BaFin can revoke an undertaking's licence.

The BMF may empower the BaFin to issue regulatory ordinances wherever an enabling clause of the VAG provides for such possibility. However, the Insurance Contract Law (*Versicherungs-vertragsgesetz*, the "**VVG**") and the ordinances issued to substantiate certain aspects of the VVG fall outside the primary scope of the BaFin's competence. The BaFin may however intervene in case of severe infringements of the VVG or regulatory ordinances issued based on the VVG.

Unlike insurance undertakings, insurance intermediaries are subject to direct supervision by the respective competent local German Chamber of Industry and Commerce (*Industrie- und Handelskammer*, "**IHK**") whereas the BaFin supervises insurance mediation only indirectly and only insofar as the insurance mediations interferes with the good governance of the respective insurance undertakings. An IHK is a public statutory body under state law with self-administration under the supervision of the respective State Ministry of Economics. The principal provisions with respect to insurance mediation are set out in the Trade Regulation Act (*Gewerbeordnung*, the "**GewO**"). Pursuant to the GewO, insurance intermediation requires prior authorisation by the competent IHK and is subject to ongoing supervision.

Anti-money laundering, anti-terrorism and sanctions laws and regulations

In addition to financial and insurance regulation, the Group must comply with anti-money laundering, anti-terrorism and sanctions laws and regulations. The Group is committed to work with international organisations, governments, law enforcement agencies, regulators and its industry peers to identify the threat of money laundering and close off channels in the financial system that money launderers, terrorists and other criminals may use.

Sanctions screening requires the Group to ensure it neither breaches legal and/or regulatory requirements nor suffers reputational damage by providing services to, or dealing directly or indirectly with persons, entities or countries who have been identified by the United Kingdom, United States, United Nations, European Union or other governmental, national and international bodies as subject to any form of restriction including financial sanctions or asset freezing orders.

The Group, like many other financial institutions, has come under greater regulatory scrutiny in recent years and expects that environment to continue for the foreseeable future, particularly as it relates to compliance with new and existing corporate governance, employee compensation, conduct of business, client monies, anti-money laundering and anti-terrorism laws and regulations, as well as the provisions of applicable sanctions programmes. Regulatory investigations and/or enforcement actions against the Group in relation to anti-money laundering, anti-terrorism and sanctions laws or regulations could result in fines, immediate reputational and regulatory risks, and materially adversely impact its business, results of operations and financial position.

Regulatory developments

The insurance industry faces a number of regulatory initiatives aimed at addressing lessons learned from the financial crisis and other industry-level issues such as payment protection insurance mis-selling. These initiatives include new prudential rules on capital adequacy frameworks, new conduct rules and new applications for those rules, and other changes as a result of regulatory investigations and actions. In addition, new UK regulatory bodies are in the process of being established and the proposals on how they will operate are still to be approved by the UK Parliament.

Structural reform of the UK financial supervisory architecture

The UK government is in the process of implementing its reform of the framework for financial regulation in the United Kingdom and the Financial Services Bill relating to these reforms was introduced in Parliament on 26 January 2012. The Financial Services Bill provides for the dual supervision of UK insurance companies by two new regulators: the Prudential Regulation Authority (the "**PRA**") and the Financial Conduct Authority (the "**FCA**"). The PRA will be a subsidiary of the Bank of England with responsibility for promoting the stable and prudent operation of the financial system through the regulation of all deposit-taking institutions, insurers and investment banks, and the FCA will be responsible for regulating conduct in retail and wholesale financial markets and the infrastructure that supports those markets. In addition, the Financial Services Bill provides for specific additional powers for the PRA and the FCA, including:

(1) the ability for the FCA to intervene in order to ban financial products from sale or to ban a firm from selling a widely accepted product if it determines such firm's sale processes to be unacceptable; and

(2) the ability for the PRA to direct an unregulated UK holding company to take a particular action, or refrain from taking a particular action, and to censure or fine such company if it does not so comply.

The new regulatory bodies are in the process of being established and the proposals on how they will operate are still to be approved by the UK Parliament. The Group's UK insurance subsidiaries will be regulated by both the PRA and the FCA, and there are risks and uncertainties as to how the two bodies will interact with each other over the regulation of the same legal entities. While the Group will seek to ensure that it is prepared for this new system of regulation, there are risks associated with the uncertainty in respect of how the new regulators intend to apply their new powers and whether the new system will result in more intrusive and intensive regulation, adding additional burdens on the Group's resources. For instance, it is unclear how the FCA intends to apply its powers in respect of the sale of financial products, and if there is any change in regulatory focus in the United Kingdom on product regulation, it may also impact the Group's ability to sell certain products in the future, which may adversely affect the Group's distribution arrangements.

The UK government's stated aim is for the Financial Services Bill to gain Royal Assent by the end of 2012 and the new regulatory framework to be operational in early 2013.

The new EU solvency regime for insurance companies

The European Commission is continuing to develop a new prudential framework for insurance companies, known as "Solvency II", that will replace the existing life, non-life, re-insurance and insurance groups directives. The main aim of this framework is to ensure the financial stability of the insurance industry across the European Union and protect policyholders through establishing solvency requirements better matched to the true risks of the business. Solvency II adopts a three-pillar approach to prudential regulation which is similar to the "Basel II" approach which has already been adopted in the banking sector in Europe. These pillars are quantitative requirements (Pillar 1); qualitative requirements (Pillar 2); and supervisory and reporting disclosure (Pillar 3).

Although the Solvency II directive has similarities to the current UK regime set out in GENPRU and INSPRU in terms of its risk-based approach to the calculation of capital resources requirements and use of capital tiering, there are also many differences both in terms of substance and terminology.

A key aspect of Solvency II is the focus on a supervisory review at the level of the individual legal entity. Insurers will be allowed to make use of internal economic capital models to calculate capital requirements if the model has been approved by the regulator. In addition, Solvency II includes a requirement that firms

develop and embed an effective risk management and internal audit system as a fundamental part of running the firm.

Solvency II is being developed in accordance with the Lamfalussy four-level process. The "Level 1" directive was formally approved by the European Parliament on 22 April 2009 and the final text was adopted by the European Council on 10 November 2009 and sets out a framework which will be supplemented by further and more detailed technical implementing measures at "Level 2". At "Level 3" non-binding standards and guidance will be agreed between national supervisors and at "Level 4" the European Commission will monitor compliance by Member States and take enforcement action as necessary. Proposed modifications to the Level 1 directive (set out in a legislative proposal from the European Commission in January 2011 referred to as the Omnibus II directive ("**Omnibus II**")) are likely to mean that, in addition, binding technical standards will be produced at "Level 2". At present, it is expected that each Member State will be required to implement the new rules by 30 June 2013, with the regime becoming binding on insurers and reinsurers within each Member State from 1 January 2014. However, uncertainty still remains as to whether there will be further legislative delays which will cause these timelines to be pushed to later dates.

Solvency II provides for the supervision of insurance groups and will impose a group-level capital requirement in relation to certain insurance groups, including the Group. Where entities in any insurance group are located in different Member States, the national supervisors of those entities will participate in a college of supervisors to supervise the group, with the FSA becoming the lead regulator for the Group as the regulator in the domicile of the Group's head office.

The Group's Solvency II programme is scheduled to meet implementation requirements and milestones (see Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Capital Resources—Solvency II*" and Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Risk management*"). However, the implementation of this programme, and the ultimate changes required to the Group's capital involve certain risks (see Part II: "*Risk Factors—Risks relating to the Group—The European Union is currently in the process of introducing a new regime governing solvency requirements, technical reserves, and other requirements for insurance companies, the effect of which is uncertain*").

The European Insurance and Occupational Pensions Authority

The European Parliament has called for a strengthening of the European supervision framework to reduce the risk and severity of future financial crises. This has led to the creation of the European Insurance and Occupational Pensions Authority ("**EIOPA**"), which is a regulatory and supervisory authority which replaces the Committee of European Insurance and Occupational Pensions Supervisors. EIOPA is part of the European System of Financial Supervisors that comprises three supervisory authorities: one for the banking sector, one for the securities sector and EIOPA for the insurance and occupational pensions sector. Under Omnibus II, EIOPA will have extended powers to develop the detailed aspects of the Solvency II regime, to provide guidelines and recommendations to national supervisors and to resolve differences between national supervisors in the supervision of international insurance groups. The Group will seek to ensure that it is prepared for regulation under the EIOPA, however there are risks associated with the uncertainty in respect of how the EIOPA intends to apply its powers and whether the new authority will result in more intrusive and intensive regulation, adding additional burdens on the Group's resources.

Payment Protection Insurance mis-selling complaints

The FSA has restricted the sales practice for creditor insurance, also known as Payment Protection Insurance ("**PPI**"), which covers the payments under financial products if the borrower is unable to make the payments due to accident, sickness, unemployment or death, and has been sold alongside unsecured or secured personal loans, credit cards and mortgages. New FSA rules took effect from December 2010 and clarified the standards that firms selling PPI should have met when explaining to potential customers the key features and exclusions of the policies. Following FSA publications on how customers can claim for mis-sold PPI, increasing numbers of customers are now claiming refunds of premiums for PPI cover which they assert was mis-sold. The Group has underwritten a significant amount of PPI business. The majority of this exposure related to policies originally underwritten by U K Insurance, which were sold in branches, online or via telephone by companies in the RBS Group's retail division. The RBS Group and the Group have agreed that responsibility for sums paid or payable to persons making PPI mis-selling complaints

belongs to the RBS Group. Consequently, the Group is not expecting to be subject to the financial costs or administrative burden relating to such mis-selling complaints. The remainder of PPI business underwritten by the Group that is not subject to that agreement relates to business where the policies were generally sold by third parties, with most of this PPI business relating to schemes which were put into run off several years ago, and the Company believes that the Group's exposure to PPI mis-selling claims is not material.

Gender neutrality regulation

As a result of a ruling by the Court of Justice of the European Union (the "**ECJ**") in March 2011 prohibiting new contracts concluded from 21 December 2012 from using gender-based factors in the calculation of individuals' premiums and benefits, Member States are to amend their existing national laws to require insurance pricing to be gender neutral by such date. The UK government is currently proposing to amend the UK Equality Act 2010 to implement the ECJ ruling with effect from 21 December 2012. The ruling will require similar changes to the laws of Italy and Germany. These changes pose risks for the Group and insurance industry generally, and will require the Group to adjust pricing structures and claims handling processes, including to limit the risk of anti-selection. While the Group's size and extensive customer data should aid its assessment of the required changes, significant adjustments to the Group's pricing and claims handling processes could have unexpected or unintended consequence on the mix of business or pricing strength of the policies written.

Market study into motor insurance by the Office of Fair Trading

The Office of Fair Trading (the "**OFT**"), together with the UK Competition Commission, enforces consumer protection laws, including those relating to price fixing, collusion and other anti-competitive behaviour in the United Kingdom. There have been several market studies and investigations on the insurance industry in recent years. For example, on 14 December 2011, the OFT launched a market study into the supply of private motor insurance in the United Kingdom, with a focus on third-party vehicle repairs and credit hire replacement vehicles to claimants. This followed the completion of a three month call for evidence on the market which indicated an increase in private motor insurance premiums paid in the United Kingdom. The OFT published a report on its market study into private motor insurance on 31 May 2012. The market study provisionally found that various practices within the industry appear to inflate both the cost of the provision of replacement vehicles and the cost of repairs to drivers involved in road traffic accidents where they are not at fault. The ultimate result of these practices potentially being that the additional costs are passed on to the consumer through higher motor insurance premiums. On 28 September 2012, the OFT confirmed its May decision to refer the UK market for the supply or acquisition of private motor insurance and related goods or services to the Competition Commission. At this stage, the Group cannot estimate with any certainty the effect the market study and any related developments may have on it, including the timing of those effects. Any failure by the Group to comply with competition laws in any jurisdiction in which it carries on business could result in regulatory sanction and reputational damage, and materially adversely impact its business, results of operations and financial position.

Civil litigation costs reform in England and Wales

As part of a growing movement toward civil litigation costs reform in England and Wales, a number of different initiatives have been discussed or proposed recently, any of which could have a significant impact on the UK insurance industry and on the Group. The most important of these include:

- ***Lord Justice Jackson's Final Report:*** As part of an ongoing government initiative to reform the civil litigation system in England and Wales, Lord Justice Jackson ("**Jackson LJ**") completed a detailed final report on costs in the English civil litigation system in January 2010 in which he recommended a number of specific changes including that general damages be increased to 10%. In March 2011, the government announced that it intends to implement most of Jackson LJ's primary recommendations, including the abolition of recoverable conditional fee agreements ("**CFA**"), success fees and after the event ("**ATE**") insurance premiums.
- ***Legal Aid, Sentencing and Punishment of Offenders Act 2012:*** On 1 May 2012 the Legal Aid, Sentencing and Punishment of Offenders Bill Act 2012 was passed, implementing many of Jackson LJ's primary recommendations. Significant provisions include, among others:

  (i) Abolishing the recoverability of CFA success fees and ATE insurance premiums from a losing party (with certain exceptions). Instead success fees and ATE insurance premiums are to be

paid by the party funded that way with the intended result of giving that party an incentive to control costs incurred on their behalf. The success fees are to be subject to a maximum limit and the government has said that it intends to retain the limit of 100% of base costs, except in personal injury cases, in which success fees will be subject to a 25% cap on damages (excluding for future care and loss).

(ii) Permitting the use of contingency fee or damaged based agreements ("**DBAs**") in civil litigation. The fees of a DBA funded lawyer relate to the damages awarded rather than the work done by the lawyer. Successful claimants funded by a DBA may be able to recover their base costs (i.e. lawyer's hourly rate fee and disbursements) from defendants in the usual way with the claimant being able to make up from the defendant any shortfall in the DBA fee the claimant owes its lawyer. DBAs are intended to be subject to similar requirements as for CFAs (e.g. the amount of payment that lawyers can take from damages in personal injury cases will be capped at 25% of damages excluding future care and loss).

(iii) Abolishing referral fees in personal injury cases (e.g. referral fees paid to insurers for referring accident victims' details to third parties in personal injury cases). The rules against referral fees apply to authorised persons under the FSMA, solicitors, barristers and any person providing claims management services under the Compensation Act 2006. Sanctions for breach of the rules will be imposed by the relevant regulator.

Only limited parts of the Act are currently in force. The provisions referred to above are expected to come into force in April 2013.

- ***Simmons v. Castle:*** In July 2012 the Court of Appeal in *Simmons v. Castle* ([2012] EWCA Civ 1039) implemented a 10% increase in general damages with effect from 1 April 2013, as recommended by the Jackson Report, but, at the time, confirmed that this uplift would apply to all claims decided after that date, irrespective of when the claim was made. However, certain other related measures to be implemented by LASPO will only come into effect for new claims commenced after 1 April 2013. This includes the cessation of recoverability of success fees and after-the-event insurance premiums from the losing party, for which the 10% general damages increase was intended to compensate.

  There is currently uncertainty arising from the Court of Appeal's decision in *Simmons v. Castle* in July 2012 and a subsequent hearing on 25 September 2012, following applications by the ABI to the Court of Appeal for it to reconsider its decision. The outcome of the recent hearing is pending as at the date of this Prospectus and, as such, the resultant impact on cost of claims for the industry is unclear. If the Court declines to amend its July decision, claimants for recoverable claims commenced before 1 April 2013 but settled or decided after 1 April 2013 will be entitled to recover a success fee and after-the-event premiums and additionally a 10% increase in the amount of general damages. See also Part XII: "*Operating and Financial Review—Current Trading*".

- ***Governments court reforms:*** In February 2012, the Ministry of Justice announced that it intends to take forward a number of measures to prevent cost escalation in county courts. These include: (i) plans to extend the system of fixed recoverable cost to include higher value and a broader range of personal injury claims with the detail being finalised after consultation with key stakeholders; and (ii) plans to increase the small claims ceiling initially to £10,000 and, after evaluating this initial increase, £15,000. There will be no change to the current limit for personal injury and housing disrepair.

- ***House of Commons Transport Committee:*** The House of Commons Transport Committee published the Twelfth Report of Session 2010-12 in January 2012, containing a range of recommendations in relation to banning all referral fees, pre-action protocol, whether the legal fees for low value claims are reasonable, potential proposals on compensation in respect of whiplash claims, and a call for increased awareness within the insurance industry with respect to its compliance with data protection legislation. The Department for Transport's response was published as the Thirteenth Special Report of Session 2010-12 on 20 April 2012 and noted the Government's commitment to implementing the Legal Aid, Sentencing and Punishment of Offenders Act 2012, extending the threshold for claims in the road traffic accident personal injury claims protocol from £10,000 to £25,000, reducing fixed fees payable to lawyers in road traffic accident personal injury claims, and reducing the number and cost of whiplash claims.

UK insurance contract law

In 2006, the Law Commissions of England and Wales and the Scottish Law Commission (the "**Law Commissions**") began a programme for the review of English and Scottish insurance contract law. In December 2009 the Law Commissions published a joint report on consumer insurance law and a draft bill introducing changes which affect insurance customer obligations regarding their disclosure of pre-contractual information to insurers and the insurers' remedies where the consumers fail to do so. The main change introduced by the proposed legislation is to replace the duty of disclosure with a duty on consumers to take reasonable care to answer insurers' questions fully and accurately. This bill, termed the Consumer Insurance (Disclosure and Representations) Act 2012 received Royal Assent on 8 March 2012 and is expected to come into force during 2013. It is expected that it will bring the legal regime more in line with the FSA regime that applies to insurers and consumers and with the decisions of the Financial Ombudsman Service.

A consultation began in December 2011 regarding the post-contract regime applying to insurers and consumers with the expectation that this will lead to further legislation on such issues as a proposed duty of the insurers to pay claims promptly (breach of which would entitle the policyholder to damages) and the consequences which flow from fraudulent claims. The consultation closed in March 2012. A further consultation opened in June 2012 regarding the business insured's duty of disclosure and the law of warranties. The consultation closes in September 2012.

The proposals and legislation remain under debate and are not fixed. Pressure may also develop from proposals under discussion in the European Union and in the context of a European initiative known as the Principles of European Insurance Contract Law, which, if they are taken forward, may increase protection for consumer and business insurance customers yet further.

Ogden discount rate

A change in the "Ogden discount rate", which is the discount rate set by the UK government and used by courts to calculate lump sum awards in bodily injury cases, would impact all relevant claims settled after that date, regardless of whether the insurance to which the claim relates was priced on that basis or not. A reduction in the Ogden discount rate would have the effect of increasing the present value of lump sum awards, thereby increasing the amount the Group would need to pay to settle certain claims. The current discount rate is 2.5% a year, and was established in 2001 for England, Wales, and Northern Ireland and in 2002 for Scotland. However the current low interest rate environment has given rise to uncertainty around the future Ogden discount rate, and on 1 August 2012, the Ministry of Justice, the Scottish Government and the Department of Justice, Northern Ireland, released a paper soliciting views on changes to the methodology for setting the Ogden discount rate. From 2010, the Group has calculated its estimated reserve based on an assumed discount rate of 1.5% in recognition of that uncertainty and its best expectations of the future rate to be applied. A reduction in the discount rate to 1.0% would result in an increase in net reserves by approximately £85 million (above the current reserve estimate based on a 1.5% discount rate); a reduction to 0.5% would result in an increase of approximately £190 million; and a reduction to 0.0% would result in an increase of approximately £310 million. See "*Risk Factors—Risks relating to the Group—A sustained period of low interest rates or interest rate volatility could adversely affect claims settlements*".

Alternative business structures

In early 2012, the Solicitors Regulation Authority began to license "alternative business structures" as permitted under Part 5 of the Legal Services Act 2007. The statute permits non-lawyers to own and invest in companies that provide legal services. The Group is currently considering participating in an alternative business structure as a potential measure to improve efficiencies relating to legal expenses, and currently expects to make the relevant application under the Legal Services Act in the second half of 2012 as part of this process.

PART X—CAPITALISATION AND INDEBTEDNESS

The table below sets out the Group's capitalisation and indebtedness as at 30 June 2012 and 31 August 2012:

	As at 30 June 2012	As at 31 August 2012
	£ million	£ million
Total current debt		
Guaranteed	—	—
Secured	—	—
Unguaranteed/unsecured	83.7	61.8
Total non-current debt		
Guaranteed	—	—
Secured	—	—
Unguaranteed/unsecured[1]	774.6	793.3
Equity		
Invested capital[2]	1,500.0	150.0
Other reserves[2]	613.6	2,012.4
Retained earnings	792.1	832.6
Total capitalisation and indebtedness	**3,764.0**	**3,850.1**

Other than a £200 million dividend paid by the Group to RBS on 3 September, there has been no material change to the Group's capitalisation and indebtedness since 31 August 2012.

The following table sets out the Group's net indebtedness as at 30 June 2012 and 31 August 2012:

	As at 30 June 2012	As at 31 August 2012
	£ million	£ million
Cash at bank and in hand	273.1	283.1
Short-term deposits with credit institutions	2,292.5	1,862.9
Trading securities	—	—
Liquidity	**2,565,6**	**2,146.0**
Current financial receivable	—	—
Current bank debt	(83.7)	(61.8)
Current portion of non-current debt	—	—
Other current financial debt	—	—
Current financial debt	**(83.7)**	**(61.8)**
Net current liquidity (financial indebtedness)	**2,481.9**	**2,084.2**
Non current bank loans—borrowings	—	—
Bonds issued—Subordinated liabilites	(516.1)	(534.8)
Other non current loans[1]	(258.5)	(258.5)
Non current financial indebtedness	**(774.6)**	**(793.3)**
Net financial liquidity	**1,707.3**	**1,290.9**

(1) Includes undated loan capital of £258.5 million provided by Tesco Personal Finance Limited. Undated loan capital is shown in the Group's combined balance sheet as a non-controlling interest, which forms part of total equity, in accordance with IFRS, in Part XIII "*Financial Information*" of this document.

(2) On 31 August 2012, the Group sub-divided its invested capital which resulted in a reduction in invested capital of £1,350 million and the corresponding creation of a non distributable capital redemption reserve of £1,350 million.

Companies within the Group have guaranteed the performance of certain contracts with insurance partners. There was a guarantee in place from 1 June 2011 until 31 January 2012 of £70 million for events occurring up to 31 January 2012, although liability under this guarantee was reduced at 31 January 2012 to £58.5 million for events occurring after that date. There are further guarantees in place which also relate to contracts with insurance partners for £90.3 million as at 30 June 2012.

The Group has no other indirect and contingent liabilities, nor any contingent commitments.

COMBINED INCOME STATEMENT

	Six months ended 30 June		Year ended 31 December		
	2012	2011	2011	2010	2009
	£ million	£ million (unaudited)	£ million	£ million	£ million
Gross earned premium	2,034.7	2,367.9	4,522.9	5,152.4	5,330.4
Reinsurance premium ceded	(164.5)	(127.5)	(269.9)	(178.9)	(202.1)
Net earned premium	**1,870.2**	**2,240.4**	**4,253.0**	**4,973.5**	**5,128.3**
Investment return	176.0	146.9	281.9	321.7	365.6
Instalment income	62.1	76.7	145.0	187.7	155.9
Other operating income	37.0	46.3	95.1	107.5	78.6
Total income	**2,145.3**	**2,510.3**	**4,775.0**	**5,590.4**	**5,728.4**
Insurance claims	(1,509.1)	(1,769.1)	(3,160.6)	(4,884.7)	(4,301.7)
Insurance claims recoverable from reinsurers	285.0	68.7	193.1	256.7	119.4
Net insurance claims	**(1,224.1)**	**(1,700.4)**	**(2,967.5)**	**(4,628.0)**	**(4,182.3)**
Commission expenses	(222.0)	(184.3)	(518.9)	(378.7)	(560.8)
Other operating expenses	(582.5)	(438.3)	(944.6)	(959.1)	(1,064.8)
Total expenses	**(804.5)**	**(622.6)**	**(1,463.5)**	**(1,337.8)**	**(1,625.6)**
Operating profit/(loss)	**116.7**	**187.3**	**344.0**	**(375.4)**	**(79.5)**
Finance costs	(10.2)	(1.4)	(2.7)	(2.7)	(4.4)
Gain recognised on disposal of subsidiary and joint venture	—	1.6	1.6	—	216.1
Profit/(loss) before tax	**106.5**	**187.5**	**342.9**	**(378.1)**	**132.2**
Tax (charge)/credit	(23.7)	(45.3)	(93.9)	106.2	0.9
Profit/(loss) for the period	**82.8**	**142.2**	**249.0**	**(271.9)**	**133.1**

RESULTS OF OPERATIONS—ONGOING OPERATIONS

Gross written premium—ongoing	2,058.4	2,093.2	4,124.9	4,095.3	4,171.6
Net earned premium—ongoing	1,860.8	1,943.7	3,890.9	3,976.8	4,029.8
Net insurance claims—ongoing	(1,253.1)	(1,442.9)	(2,731.0)	(3,588.3)	(3,240.3)
Commission expenses—ongoing	(155.9)	(150.2)	(394.6)	(352.9)	(300.9)
Other operating expenses—ongoing	(471.8)	(400.8)	(837.6)	(851.8)	(895.8)
Underwriting result—ongoing	**(20.0)**	**(50.2)**	**(72.3)**	**(816.2)**	**(407.2)**
Investment return—ongoing	145.4	125.5	238.7	281.4	306.3
Instalment income and other operating income—ongoing	98.8	134.2	255.5	329.1	266.5
Operating profit/(loss)—ongoing	**224.2**	**209.5**	**421.9**	**(205.7)**	**165.6**

KEY PERFORMANCE INDICATORS

	Six months ended 30 June		Year ended 31 December		
	2012	2011	2011	2010	2009
	£ million	£ million (unaudited)	£ million	£ million	£ million
Ongoing operations					
Loss ratio	67.3%	74.2%	70.2%	90.2%	80.4%
Commission ratio	8.4%	7.7%	10.1%	8.9%	7.5%
Expense ratio	25.4%	20.6%	21.5%	21.4%	22.2%
Combined operating ratio-ongoing					
Motor	102.4%	107.0%	105.6%	144.1%	125.7%
Home	103.4%	98.6%	95.1%	91.0%	90.8%
Rescue and other personal lines	75.7%	82.4%	86.3%	87.0%	81.9%
Commercial	112.7%	103.7%	112.3%	121.6%	108.3%
International	103.0%	112.5%	107.6%	107.9%	109.2%
Total Combined Operating Ratio	101.1%	102.5%	101.8%	120.5%	110.1%
Ongoing in-force polices (millions)	20.1	20.0	19.4	20.0	20.1
Earnings per share—basic and diluted (pence)	5.5p	9.5p	16.6p	(18.1)p	8.9p
Adjusted earnings per share—basic and diluted (pence)[1]	10.8p	10.2p	20.5p	(10.0)p	7.8p
Net assets per share (pence)	193.7p	n/a	240.9p	214.9p	221.5p
Net tangible assets per share	167.7p	n/a	216.5p	195.8p	202.1p
Return on Equity	4.7%**	n/a	7.3%	(8.3)%	4.3%
Return on tangible equity[1]	10.2%**	n/a	10.0%	(5.0)%	4.2%

** annualised

(1) See Part V: "*Presentation of Information—Presentation of Financial Information*" for definition and calculation of these non-IFRS measures.

COMBINED CASH FLOW STATEMENT

	Six months ended 30 June		Year ended 31 December		
	2012	2011	2011	2010	2009
	£ million	£ million (unaudited)	£ million	£ million	£ million
Opening cash and cash equivalents	1,309.6	1,763.5	1,763.5	1,225.9	238.5
Net cash (used by) generated from operating activities before investment of insurance assets	(414.3)	(165.8)	(359.8)	89.2	(178.1)
Cash generated from (used by) investment of insurance assets	2,239.9	(673.9)	38.8	486.0	875.7
Net cash (used by) generated from investing activities	(88.0)	(33.4)	(126.2)	(31.3)	316.0
Net cash (used by) generated from financing activities	(553.4)	(0.2)	(0.5)	(0.9)	(0.8)
Effect of foreign exchange rate changes	(11.9)	14.3	(6.2)	(5.4)	(25.4)
Closing cash and cash equivalents	**2,481.9**	**904.5**	**1,309.6**	**1,763.5**	**1,225.9**

COMBINED BALANCE SHEET

	As at 30 June 2012	As at 31 December 2011	2010	2009
	£ million	£ million (unaudited)	£ million	£ million
Assets				
Goodwill and other intangible assets	390.9	365.8	286.1	290.3
Financial investments, cash and cash equivalents	10,081.4	10,860.1	10,671.9	10,008.2
Other assets	2,738.0	2,544.2	2,858.9	2,887.3
Total assets	**13,210.3**	**13,770.1**	**13,816.9**	**13,185.8**
Liabilities				
Insurance liabilities and unearned premium reserve	8,461.3	8,440.6	9,230.0	8,428.3
Borrowings	83.7	317.9	327.1	285.2
Other liabilities	1,501.1	1,140.3	777.7	891.7
Total liabilities	**10,046.1**	**9,898.8**	**10,334.8**	**9,605.2**
Equity				
Total invested equity	2,905.7	3,612.8	3,223.6	3,322.1
Non-controlling interest	258.5	258.5	258.5	258.5
Total equity	**3,164.2**	**3,871.3**	**3,482.1**	**3,580.6**
Total equity and liabilities	**13,210.3**	**13,770.1**	**13,816.9**	**13,185.8**

PART XII—OPERATING AND FINANCIAL REVIEW

The section that follows should be read in conjunction with Part VII: "Information on the Company and the Group" and Part XI: "Selected Financial Information". Prospective investors should read the entire document and not just rely on the summary information set out below. The financial information considered in this Part XII is extracted from the Group's historical financial information included in Part XIII: "Financial Information" of this prospectus.

The combined financial information presented in this prospectus has been prepared for the combined group which comprises the Company and its subsidiaries. The combined financial information has been prepared in accordance with the requirements of the PD regulation and the Listing Rules in accordance with the basis of preparation included in Note 1, Accounting policies, in the Group's historical financial information included in Part XIII: "*Financial Information*". As described in Part XIII: "*Financial Information—Basis of Preparation of the Historical financial Information*", the combined financial information has been prepared in accordance with IFRS as adopted by the EU except for the inclusion, in the preparation of the combined financial information, of certain costs incurred by the RBS Group in respect of services provided to the Group that were not invoiced by the RBS Group. The Conceptual Framework for Financial Reporting, paragraph 4.49, gives guidance that expenses should be recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase in a liability has arisen. As there is no contractual liability to pay and therefore no liability has arisen in connection with these costs, the costs would not be recorded in the combined financial information of the Group under IFRS. The combined financial information includes these costs in order to present the cost base of the Group during the period covered by the combined financial information.

In addition to historical information, the following discussion and other parts of this prospectus contain forward-looking information that involves risks and uncertainties. Accordingly, the results of operations for the periods reflected herein are not necessarily indicative of results that may be expected for future periods, and the Group's actual results may differ materially from those discussed in the forward-looking statements as a result of various factors, including those set forth under Part II: "Risk Factors". In addition, certain regulatory issues also affect the Group's results of operations and are described in Part IX: "Regulatory Overview".

OVERVIEW

Direct Line Group is a retail general insurer with leading market positions in the United Kingdom, a strong presence in the direct motor channel in Italy and Germany and a focused position in UK SME Commercial. The Group utilises a multi-brand, multi-product and multi-distribution channel business model that covers most major customer segments in the United Kingdom for personal lines general insurance and a more limited presence in the commercial market. The Group occupies leading market positions in terms of in-force policies and has the most highly recognised brands in the United Kingdom for personal motor insurance and personal home insurance.

The Group's business is comprised of the following five reportable segments:

- ***Motor:*** With 27 years of experience in motor insurance, the Group is the leading personal motor insurer in the United Kingdom in terms of in-force policies, with approximately 4.1 million in-force policies as at 31 December 2011 and 4.2 million in-force policies as at 30 June 2012 and a market share of 19% as at 31 December 2011 (source: Motor & Home market share data © GfK NOP Financial Research Survey (FRS) 3 months ending Dec 2011, 6,901 adults interviewed for Motor and 7,234 for Home). In addition to core motor insurance cover of third-party liability, fire and theft, accidental damage, and protection for no-claims discount, the Group offers insurance cover that includes motor legal protection and guaranteed hire car. The Group sells motor insurance in the United Kingdom through its own brands—Direct Line, Churchill, and Privilege—and through distribution partnerships with a number of household names, including Prudential, RBS/NatWest, Sainsbury's, Peugeot and Citroen. The Group's brand and product offering covers most major retail customer segments for motor insurance in the United Kingdom. For the six months ended 30 June 2012 gross written premiums for the Group's motor insurance business were £842.1 million, representing 40.9% of total ongoing gross written premiums for the Group, and for the year ended 31 December 2011, gross written premiums for the Group's motor insurance business were £1,734.8 million, representing 42.1% of total ongoing gross written premiums for the Group.
- ***Home:*** The Group is also the leading personal home insurer in the United Kingdom in terms of in-force policies, with approximately 4.3 million in-force policies as at 31 December 2011 and

4.3 million in-force policies as at 30 June 2012 and a market share of 18% as at 31 December 2011 (source: Motor & Home market share data © GfK NOP Financial Research Survey (FRS) 3 months ending Dec 2011, 6,901 adults interviewed for Motor and 7,234 for Home). In addition to core home insurance cover of buildings, contents, accidental damage and personal possessions, the Group offers insurance cover that includes family legal protection and home emergency. The Group sells home insurance in the United Kingdom through its own brands—Direct Line, Churchill, and Privilege—and through distribution partnerships with a range of well-known brands, including RBS/NatWest, Nationwide, Sainsbury's and Prudential. As with the Group's motor insurance business, the Group's brand and product offering covers most major retail customer segments for home insurance in the United Kingdom. For the six months ended 30 June 2012 gross written premiums for the Group's home insurance business were £484.4 million, representing 23.5% of total ongoing gross written premiums for the Group and for the year ended 31 December 2011, gross written premiums for the Group's home insurance business were £1,031.3 million, representing 25.0% of total ongoing gross written premiums for the Group.

- ***Rescue and Other Personal Lines:*** The Group's rescue and other personal lines business in the United Kingdom includes rescue and recovery insurance products as well as travel and pet insurance, with approximately 9.2 million in-force policies as at 31 December 2011 and 9.7 million in-force policies as at 30 June 2012. Green Flag, the Group's rescue and recovery brand, operates the United Kingdom's third largest roadside rescue and recovery service in terms of members with an estimated market share of 16.3% for 2011 (source: Mintel Study 2011, excludes multiple personal third-party and manufacturer memberships). DLG sells its other personal lines insurance through the Direct Line, Churchill and Privilege brands, and through its distribution partnerships, including those with Prudential, RBS/NatWest and Nationwide. For the six months ended 30 June 2012 gross written premiums for the Group's rescue and other personal lines business were £199.3 million, representing 9.7% of total ongoing gross written premiums for the Group and for the year ended 31 December 2011, gross written premiums for the Group's rescue and other personal lines business were £350.2 million, representing 8.5% of total ongoing gross written premiums for the Group.
- ***Commercial:*** The Group provides commercial insurance predominantly for micro businesses and SMEs in the United Kingdom, with approximately 0.4 million in-force policies as at 31 December 2011 and 0.5 million in-force policies as at 30 June 2012 and an estimated market share of 9% within the micro business and SME market as at 31 December 2011. The Group's commercial products include commercial property, business interruption, general liability, personal accident and commercial motor insurance, and are sold through its own brands—NIG and DL4B—and through its distribution partnerships with RBS/NatWest. For the six months ended 30 June 2012 gross written premiums for the Group's commercial insurance business were £229.8 million, representing 11.2% of total ongoing gross written premiums for the Group and for the year ended 31 December 2011, gross written premiums for the Group's commercial insurance business were £438.6 million, representing 10.6% of total ongoing gross written premiums for the Group.
- ***International:*** In addition to its UK business, the Group sells motor insurance in Germany and Italy primarily through its Direct Line brand. The Group sells its motor insurance to private customers in Germany and Italy (which represent the two largest motor vehicle markets in Europe) using a multi-channel strategy similar to that used in the United Kingdom, with approximately 1.4 million in-force policies as at both 31 December 2011 and 30 June 2012, and a market share of 31% within the Italian direct motor market and 12% within the German direct motor market in 2011 (source: ANIA Italiana Report; GDV Direct Market Study 2011, respectively). The Group's international insurance business has grown in terms of gross written premiums at a CAGR of 26.9% from 2009 to 2011. For the six months ended 30 June 2012 gross written premiums for the Group's international insurance business were £302.8 million, representing 14.7% of total ongoing gross written premiums for the Group and for the year ended 31 December 2011, gross written premiums for the Group's international insurance business were £570.0 million, representing 13.8% of total ongoing gross written premiums for the Group.

Transformation plan and separation from the RBS Group

Through the late 1990s and 2000s, industry-wide changes in credit hire, bodily injury claims driven by increased penetration of claims management companies, an increase in no-win/no-fee arrangements, and increases in PPO propensity substantially increased the demands on the Group's operating models and systems including complex and geographically fragmented UK claims management processes. The

combination of these events had a negative impact on Group trading and resulted in a period of financial underperformance for the Group, whereby operating losses of £375.4 million and £79.5 million were incurred in the years ended 31 December 2010 and 2009, respectively. Beginning in late 2009, the Group undertook the first stages of its transformation plan encompassing a range of initiatives aimed at improving profitability and better leveraging the competitive advantages it holds through its brands and large scale. The key aspects of those initiatives included significantly enhancing the Group's pricing capabilities, discontinuing certain unprofitable business lines, rationalising certain operations and significantly increasing its technical reserves relating to prior year claims.

As a result of its decision to discontinue certain of its business lines, the Group presents a portion of its business in run-off from 2009 onward. The businesses included in the run-off category include Linea Directa, which was sold in 2009, and the TPF and NIG personal lines broker businesses, which the Group is in the process of terminating and for which no new policies are being written. The run-off category includes only these three businesses. In addition, other impacts to the Group's financial information resulting from the transformation plan and separation from the RBS Group are reflected in restructuring and other one-off costs as well as the results for the ongoing businesses. Neither the run-off category nor the restructuring and other one-off costs category represent reportable segments in accordance with IFRS. The Group believes presentation of a separate run-off category and a restructuring and other one-off costs category allows the Group to focus on the performance of its ongoing businesses, which the Board believes presents a more accurate view of likely performance going forward. Financial information for the Group's run-off category and restructuring and other one-off costs category appears in Note 4 of the Group's historical financial information included in Part XIII: "*Financial Information*", and is discussed in the line item "Operating profit/(loss) from run-off activities" under "*—Results of operations—Group results of operations*" below.

The Group's decision to significantly increase its technical reserves in 2009 and 2010 following a number of adverse industry-wide developments in motor bodily injury claims resulted in operating losses in the years ended 31 December 2009 and 2010. While the Group cannot be certain it will not need to make similar increases to its reserves in response to future developments, the Board believes that, because of the financial impact of the reserving actions taken in 2009 and 2010, the performance of the business in those years should not be viewed as indicative of future trends in the business.

In addition, in 2009, the RBS Group committed to the European Commission to sell its insurance business as a condition of its receipt of State Aid. To comply with this requirement, the RBS Group must cede control of the Group by the end of 2013 and must have divested its entire interest by the end of 2014. In preparation for this divestment, the Group and the RBS Group commenced a process of separation and systems migration. The separation and migration process entails: a reorganisation and separation of core operations and systems such as human resources and payroll, head office, governance and controlled functions; migration of certain assets, IT, and employees; entry into new arm's-length agreements with respect to provision of services and distribution of Group products; and other one-off separation actions.

Since 1 July 2012, the Group has been operating on a substantially standalone basis from the RBS Group, with independent corporate functions and governance following the completion of a number of separation initiatives, including launching a new corporate identity, confirming further senior management appointments, the appointment of additional non-executive directors and a new non-executive chairman, agreeing and issuing new terms and conditions for staff, and implementing new HR systems. The Group expects a substantial amount of the IT and other systems migration and related one-off costs to be incurred in 2012, 2013 and 2014 and to principally affect the line item "Restructuring and other one-off costs" (see "*—Key factors affecting results of operations—Cost and operational efficiency*").

BASIS OF PREPARATION

The combined financial information presented in this prospectus has been prepared for the combined group which comprises the Company and its subsidiaries. The combined financial information has been prepared on a historical cost basis except for investment properties and those financial instruments that have been measured at fair value.

IFRS as adopted by the EU do not provide for the preparation of combined financial information and accordingly, certain accounting conventions commonly used in the preparation of historical financial

information issued by the UK Auditing Practices Board have been applied. The application of these conventions results in a material departure from IFRS as adopted by the EU with respect to the following:

- The Group has incurred certain costs in respect of services provided to the Group by RBS Group that were incurred but not invoiced by RBS Group. The Conceptual Framework for Financial Reporting, paragraph 4.49, gives guidance that expenses should be recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen. As there is no contractual liability to pay and therefore no liability has arisen in connection with these costs, the costs would not be recorded in the combined financial information of the Group under IFRS.
- The combined financial information includes these costs in order to present the cost base of the Group during the period covered by the combined financial information. As these cost allocations did not result in a corresponding cash payment, they are offset by an entry in equity, described as 'demerger reserves', and are reflected in the notes to the cash flow statements see Note 35 to the Group's historical financial information included in Part XIII: "*Financial Information*" within 'non cash movement in demerger reserve'.

The Group was formed following the acquisition of Direct Line Versicherung AG by the Company. Prior to this date, the Group was not held by a single legal entity and, accordingly, consolidated financial statements do not exist. The combined financial information has been prepared using merger accounting principles, as if the transaction that gave rise to the formation of the Group had taken place at 1 January 2009.

For more information, see "*Basis of preparation*" in the Group's historical financial information included in Part XIII: "*Financial Information*".

KEY PERFORMANCE INDICATORS

Management uses a variety of key indicators to aid in assessing the Group's financial performance. The Board believes that each of these measures provides useful information with respect to the performance of its business and operations. However, certain key performance indicators are non-IFRS financial measures and should not be viewed as a substitute for financial measures determined in accordance with IFRS. Furthermore, these measures may be defined or calculated differently by other companies, and as a result the key performance indicators of the Group may not be comparable to similar measures calculated by its peers.

The table below presents key performance indicators for the Group's ongoing operations as well as its total operations as at and for the six months ended 30 June 2012 and 2011, and as at and for each of the years ended 31 December 2011, 2010, and 2009.

	Six months ended 30 June		Year ended 31 December		
	2012	2011	2011	2010	2009
	(millions, £ except policies and ratios)				
Ongoing operations[1]					
Gross written premium	2,058.4	2,093.2	4,124.9	4,095.3	4,171.6
Operating profit/(loss)	224.2	209.5	421.9	(205.7)	165.6
In-force policies	20.1	20.0	19.4	20.0	20.1
Return on tangible equity[2]	10.2%	n/a	10.0%	(5.0)%	4.2%
Loss ratio	67.3%	74.2%	70.2%	90.2%	80.4%
Commission ratio	8.4%	7.7%	10.1%	8.9%	7.5%
Expense ratio	25.4%	20.6%	21.5%	21.4%	22.2%
Combined operating ratio	**101.1%**	**102.5%**	**101.8%**	**120.5%**	**110.1%**
Current year combined operating ratio	113.4%	106.2%	106.7%	115.8%	112.1%
Total operations					
Investment income yield[3]	2.1%	n/a	2.3%	2.6%	3.2%
Operating profit/(loss)	116.7	187.5	344.0	(375.3)	(79.5)
Return on equity[2]	4.7%	n/a	7.3%	(8.3)%	4.3%
Other financial information					
Pro forma return on tangible equity[4]	12.1%	n/a	n/a	n/a	n/a

(1) Excludes run off businesses and restructuring and other one-off costs. See Note 4 to the Group's historical financial information included in Part XIII: "*Financial Information*".

(2) Return on tangible equity (for ongoing operations) and return on equity (for total operations) for the six months ended 30 June 2012 are presented on an annualised basis. The Group calculates annualised return on equity and return on tangible equity by multiplying profit after tax or adjusted profit after tax, as the case may be, for the period by the number of such periods comprising a calendar year and dividing by average invested equity or by average tangible invested equity respectively during that period, adjusted for the weighted average value of dividends paid during the period. For further discussion on the Group's calculation methodology for return on equity and return on tangible equity, see Part V: "*Presentation of Information—Presentation of Financial Information*". Return on tangible equity for the six months ended 30 June 2011 is not calculated as no audited balance sheet information is provided as at 30 June 2011.

(3) Investment income yield is calculated as investment income divided by the average of the aggregated beginning of the year and end of the year balances for investment property, financial investments and cash and cash equivalents.

(4) In addition, return on tangible equity for the six months ended 30 June 2012 is presented on a *pro-forma* basis and assumes that the capital actions undertaken in the first half of 2012 had all taken place as at 1 January 2012. The Group believes the *pro-forma* return on tangible equity from ongoing operations for the six months ended 30 June 2012 provides an alternative measure of the Group's performance consistent with its ongoing capital position. However, the *pro-forma* financial information has been prepared for illustrative purposes only and, because of its nature, addresses a hypothetical situation and therefore does not represent the Group's actual return on equity for the six months ended 30 June 2012. See Part XIV: "*Unaudited pro forma financial information*" for a description of how the Group calculates *pro-forma* return on tangible equity for the six months ended 30 June 2012.

Gross written premium

Gross written premium from ongoing operations represents the total premiums expected to be received by the Group over the life of insurance contracts written during the period, before deducting the cost of premiums in relation to risk passed on to reinsurers. The Group uses gross written premium to assess the overall size and growth in volume of its business and to compare the size of its business with its competitors.

Gross written premium from the Group's ongoing operations was £2,058.4 million and £2,093.2 million for the six months ended 30 June 2012 and 2011, respectively, primarily reflecting small decreases in the Group's motor and home businesses partially offset by a small increase in the Group's rescue and other personal lines business. Gross written premium from the Group's ongoing operations was £4,124.9 million, £4,095.3 million, and £4,171.6 million for the years ended 31 December 2011, 2010, and 2009, respectively, primarily reflecting decreases within the Group's motor business as a result of de-risking actions offset by

increases within the Group's international business as a result of the Group's expansion strategy in Italy and Germany.

In-force policies

In-force policies from ongoing operations refers to the total number of policies on a given date that are active and against which the Group will pay following a valid insurance claim. The Group uses in-force policies as an additional measure of the size of its business and to compare the size of its business with its competitors.

As at 30 June 2012, the number of in-force policies for the Group's ongoing operations was 20.1 million, an increase of 4% compared with the number at 31 December 2011, reflecting relatively stable in-force policies within the Group's motor, home, commercial and international businesses, and an increase of 0.5 million in-force policies within the Group's rescue and other personal lines business, largely due to an increase in travel policies from packaged bank accounts. In-force policies for the Group's ongoing operations totalled 19.4 million, 20.0 million, and 20.1 million as at 31 December 2011, 2010, and 2009, respectively. The decrease primarily reflects the Group's efforts to reduce its overall exposure to higher-risk policyholders, such as young drivers, which resulted in a reduction in the number of in-force policies primarily within its motor business.

Return on tangible equity

The Group uses return on tangible equity from ongoing operations as a measure of its overall performance and to compare the Group's efficiency at generating profits from its shareholders' equity (excluding goodwill and intangible assets) with that of its competitors. The Group targets an overall return on tangible equity from ongoing operations of 15.0%.

Annualised return on tangible equity from ongoing operations for the six months ended 30 June 2012 was 10.2%. Had the capital actions taken by the Group during the first half of 2012 (which consists of the £800 million in dividends paid to the RBS Group and issuance of the £500 million Notes) occurred on 1 January 2012, annualised return on tangible equity from ongoing operations for the six months ended 30 June 2012 would have been 12.1% (see Part XIV: "*Unaudited Pro Forma Financial Information*" for further information). Return on tangible equity from ongoing operations was 10.0% in the year ended 31 December 2011 reflecting the Group's return to profit. Return on tangible equity from ongoing operations was (5.0)% and 4.2% for the years ended 31 December 2010 and 2009, respectively, reflecting the Group's period of operating losses and underperformance in 2010 and 2009 as well as the significant increase to its technical reserves relating to motor bodily injury during those years.

For the Group's definition and reconciliation of return on tangible equity, see Part V: "*Presentation of Information—Return on tangible equity*".

Combined operating ratio

Combined operating ratio from ongoing operations is calculated by dividing (i) the sum of net insurance claims, commission expenses, and other operating expenses by (ii) net earned premium, and expressed as a percentage. It is equal to the sum of the loss, commission, and expense ratios, which are each calculated by dividing net insurance claims, commission expenses, or other operating expenses by net earned premium, respectively.

Combined operating ratio is a common key performance indicator for insurance companies, but is inconsistently reported across the insurance market. The Group does not include instalment and other operating income in its calculation of combined operating ratio. As a result, the combined operating ratio is not always a directly comparable metric between insurance companies and, where appropriate, adjustments would need to be made in order to ensure a consistent basis on which to evaluate the Group's combined operating ratio as compared with those of its competitors.

The Group uses combined operating ratio to measure its overall profitability. The Group's combined operating ratio in its motor and international businesses, the latter of which consists mostly of motor insurance, has been higher in recent years, largely as a result of higher loss ratios driven in part by reserve increases in 2009 and 2010. The combined operating ratio for the Group's commercial business has also been high historically as a result of moderately higher loss and expense ratios coupled with higher commission ratios. The Group is targeting a combined operating ratio from ongoing operations of 98% by 2013. See Part V: "*Presentation of Information—Presentation of Financial Information—Financial targets*".

The combined operating ratio from the Group's ongoing operations was 101.1% and 102.5% for the six months ended 30 June 2012 and 2011, respectively, reflecting improvements to the loss ratio in the first half of 2012 despite adverse weather-related claims in the Group's home insurance business, offset by a higher expense ratio as a result of central overhead costs relating to the establishment of the Group's separate corporate functions, higher management recharges from the RBS Group, and accelerated expenditures on marketing activities. The combined operating ratio for the Group's ongoing operations was 101.8%, 120.5%, and 110.1% for the years ended 31 December 2011, 2010, and 2009, respectively, reflecting substantial increases in loss ratio for the Group's motor business in 2010 and 2009 as well as higher combined operating ratio for the Group's commercial business in 2010.

Current year combined operating ratio

Current year combined operating ratio from ongoing operations is calculated by taking the combined operating ratio from ongoing operations and excluding the effect of any increase or decrease to prior year reserves during the relevant period (see "*—Key Factors Affecting Results of Operations—Claims and reserving—Reserve releases*" for a discussion on the Group's reserve releases). The Group uses current year combined operating ratio as an alternative to combined operating ratio to measure underlying underwriting performance of the business during a given period. The Group believes that by excluding prior year movements to reserves, which themselves result from changes to the assumptions and expectations with respect to claims originating from insurance policies underwritten in previous years, the current year combined operating ratio gives an additional measure of underwriting performance during that period. Current year combined operating ratios have historically been highest within the Group's motor, commercial, and international businesses.

As a result of increases to the Group's reserves in 2010 and 2009, current year combined operating ratio for those years is significantly lower than the overall combined operating ratio from ongoing operations, whereas in 2011, reserve releases resulted in lower overall combined operating ratios. The current year combined operating ratio from the Group's ongoing operations was 113.4% and 106.2% for the six months ended 30 June 2012 and 2011, respectively, reflecting the impact of adverse weather in the Group's home insurance business and large one-off property insurance losses in its commercial insurance business. The current year combined operating ratio for the Group's ongoing operations was 106.7%, 115.8%, and 112.1% for the years ended 31 December 2011, 2010, and 2009, respectively, reflecting higher ratios within the Group's motor and international businesses in 2010 and 2009 and higher ratios within the Group's commercial business across the three-year period, with a significant increase in 2010.

Investment income yield

Investment income yield is calculated by dividing investment income by average investment portfolio (calculated as the average of the opening and closing total investment portfolio for the period) and expressed as a percentage. Investment income comprises interest income on debt securities, dividend income from equities (which ceased in 2009 following the Group's disposal of its equity investments), other investment fund income, cash and cash equivalent interest income and income from property. The Group uses investment income yield to measure the overall performance of its investment portfolio, and presents investment income yield for its whole portfolio (including the TPF portfolio, which is accounted for in profit/(loss) from run-off activities, and the international portfolios). The Group's investment portfolio is currently comprised primarily of fixed income securities, and as a result return on investments is affected by markets in interest rates and credit spreads.

The Group's investment income yield was 2.1% for the six months ended 30 June 2012, compared with 2.3%, 2.6% and 3.2% for the years ended 31 December 2011, 2010, and 2009, respectively. The decrease reflects lower overall returns on investments as well as high holdings of cash during the six months ended 30 June 2012, particularly in support of the TPF portfolio.

KEY FACTORS AFFECTING RESULTS OF OPERATIONS

The Group's results of operations are generally affected by a number of external and internal factors. Insurance industry and macroeconomic trends such as the impacts of competition and newer distribution channels, changes to consumer appetite for particular insurance products, fluctuations in markets from which the Group generates investment income, and changes to the legal and regulatory environment all affect the Group and the insurance industry as a whole. In addition, the Group's underwriting results and profitability are affected by its ability to price the risk of insurance claims with technical accuracy, adjust in

a timely manner to market pricing dynamics, respond to trends in claims and accurately adjust its reserves, manage the cost of claims efficiently, and manage its costs of operations. The following is a description of the most important factors affecting the Group's results of operations. Certain risks and other factors which may affect the Group's business are discussed in Part II: "*Risk Factors*".

Technical pricing

Technical pricing requires a critical understanding of the underlying risk in order to estimate future claims costs. The Group has undertaken several initiatives as part of its transformation plan to improve its pricing models and systems, in particular the deployment of a new pricing engine in 2010, improvements to its internal and external data collection and better utilisation of existing data. See Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Pricing*" for further detail on these initiatives. As a result of improving its pricing models and systems, the Group has during the periods under review been able to make significant changes to its risk mix, particularly for motor insurance, where the Group has reduced its overall exposure to higher risk policyholders, such as young drivers and those that reside in higher risk areas, and to update its pricing models to more accurately reflect both technical and market pricing information. The Group also raised its prices significantly since 2009, and as a result gross written premium from its ongoing business remained relatively stable even though the number of in-force policies decreased, particularly within the Group's motor business.

As a result of these pricing actions, coupled with prior year reserve releases in the Group's motor business of £138.2 million in 2011 and £108.5 million in the first half of 2012, the Group significantly improved the performance of its motor business, improving from an operating loss of £132.0 million in the year ended 31 December 2009 to an operating profit of £254.8 million in the year ended 31 December 2011 while in-force motor policies decreased from 5.6 million as at 31 December 2009 to 4.1 million as at 31 December 2011. In the six months ended 30 June 2012, the Group's motor business continued to improve, with operating profit of £146.2 million, while in-force policies increased to 4.2 million as at 30 June 2012. The Group expects to receive further benefits from the deployment of the remaining technical pricing initiatives and continued investment in pricing capabilities. However, it believes the most significant improvements occurred from historical investment during the periods under review, and further improvements to pricing ability will be more incremental in nature than in those periods.

Competitive pricing and distribution trends

In addition to accurate technical pricing of risk, the Group is subject to industry-wide and macroeconomic trends that affect its ability to win new customers and grow its business. In the UK in particular, the competitive landscape for personal insurance has been affected by increased competition from other distribution channels, in particular PCWs. In recent years, a substantial and increasing amount of new general insurance policies has been sold through PCWs, particularly motor insurance, as customers have increasingly favoured PCWs to direct internet quotes when shopping for new policies. In July 2012, the Group launched its Churchill and Privilege brands on comparethemarket.com, following which both brands were available on all four major PCWs in the UK. Though the long-term implications of the growth in PCWs cannot be fully predicted, the increasing use of PCWs has resulted in, and the Group expects it to continue to result in, greater pricing pressure and a greater incidence of customers switching their insurance policies, thereby increasing overall acquisition costs and potentially reducing the profitability of the business written due to lower or eliminated margins.

Greater macroeconomic and other social factors that affect the behaviour of the Group's customers can also lead to pricing pressures and other changes to the markets in which the Group sells its products. For example, changes in lifestyle, technology or regulation could significantly alter customers' actual or perceived need for insurance, and the types of insurance sought. Changes to customer behaviour, whether through the use of PCWs or otherwise, can also result in higher customer turnover. On average, the Group incurs fewer costs and/or makes higher profit retaining existing customers than it does acquiring new customers. This is true even for customers who replace one Group product with a comparable Group product offered under another brand. As a result, higher customer turnover could lead to higher overall costs and/or lower or eliminated profit margins due to increased pricing pressure.

Claims management

In addition to accurate and competitive pricing, the Group seeks to control the costs of managing its claims in order to improve profitability. The Group believes that an efficient and effective claims management system and associated processes are key to controlling claims costs, and the Group applies this philosophy throughout all its claims functions, including those in Italy and Germany. Better claims management can also result in reserve releases from previous years where the ultimate settlement is lower than the amount initially reserved. As part of the transformation plan, the Group implemented a new claims management system in 2011 and plans to bring the majority of new UK claims onto one common system by the end of 2013. All new motor claims for the Group's own brands have been processed on the system since the end of 2011 and all new home claims are scheduled to be processed on the system by the end of 2013 with commercial claims following in 2014. For further discussion of the Group's claims management systems, see Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Claims management*".

As a result of these efforts, the performance of the Group's claims function, particularly within motor bodily injury claims, has improved significantly. From 2009 to 2011, the Group's observed bodily injury severity inflation rate reduced from an increase of 14% to a decrease of 3%. Over that same period, the Group's settled litigation rate on bodily injury claimants decreased from 15% to 12%, while the percentage of bodily injury claims settled within 12 months (excluding nil settlements) improved from 17% to 21%. The Group expects to achieve further improvements to claims management through 2013, when all claims from the Group's motor, home, and commercial businesses are expected to be managed on the new system.

Claims and reserving

The Group maintains technical reserves to cover the estimated cost of future claims payments and related administrative expenses, with respect to losses or injuries which have been incurred but have not been fully settled at the balance sheet date or which may occur in the future against insurance policies which have already been written prior to the balance sheet date. This includes losses or injuries that have been reported to the Group and those that have not yet been reported. The technical reserves maintained by the Group represent estimates of all expected future payments, including related administrative expenses, to bring every claim (whether reported or not) which has occurred prior to the balance sheet date to final settlement.

The Group's ability to maintain appropriate technical reserves depends upon a range of actuarial and statistical projections and assumptions. Original assumptions about future claims are factored into the Group's pricing. The Group's claims function uses a number of different metrics to evaluate claims performance and inform assumptions about future claims, including average incurred severity inflation, average settled claims cost, litigation rates, and settlement rates and timing. Assumptions about future claims may change as claims develop, however, and the Group responds to those claims developments through changes in its reserving.

Claims frequency and severity

Claims cost for a given financial year is sensitive to changes in the frequency and severity of claims. Changes in the average size and frequency of claims affect the Group's results directly through the impact of such changes on claims incurred and indirectly through their impact on technical reserves and future pricing. Increases to the size and/or frequency of claims can adversely affect the profitability of the Group.

A number of specific factors influence the size and frequency of claims, and in recent years the Group's motor and home insurance businesses have been affected by changes in the size and frequency of claims. In particular, in 2009 and 2010, the Group experienced a significant increase in the size and frequency of bodily injury claims resulting in part from the rise of claims management companies and an increase in no-win/no-fee litigation. These changes to motor bodily injury claims and awards can affect the Group in several ways. Bodily injury claims often take several years to settle, and it has historically been necessary, and may over time continue to be necessary, for the Group to revise its estimates of the total costs to settle the claims and, therefore, adjust its related technical reserves (see "*—Claims development*" below).

In addition, adverse weather conditions and catastrophic events have had, and will continue to have, a significant impact on the size and frequency of claims, particularly with respect to the Group's motor and home insurance businesses, and will therefore continue to have a significant effect on the Group's results.

The frequency and severity of major events and catastrophes are inherently unpredictable. Though the Group did not experience any catastrophe claims during the periods under review, it did experience the following adverse weather events:

- unusually cold weather in the first and fourth quarters of 2010, resulting in additional claims of £149.1 million to the Group's home insurance business, some of which was reported in the first quarter of 2011; and
- unusually cold and wet weather in the first half of 2012, resulting in additional claims to the Group's home insurance business of approximately £50 million in excess of the expected amount of £40 million.

The Group has historically experienced increased size and frequency of claims in the first and fourth quarters of the year as a result of adverse weather occurring during the winter months. The Group has historically experienced lower claims, both in size and frequency, during the second and third quarters, and as a result experienced little seasonal variation between the first and second halves of the year. The Group has in the past also experienced catastrophe claims during the summer months, particularly with regard to significant floods such as those experienced in June and July in 2007 and to a lesser extent over the summer of 2012. This seasonal variation may limit the overall comparability of interim financial periods. The frequency and severity of major events and catastrophes are subject to long term external influences, such as climate change, and their impact should be considered in assessing the Group's results for any given period.

Reinsurance

The Group purchases reinsurance to provide cover against substantial individual claims or an accumulation of claims arising from a catastrophe event such as wind, storm or flood. The Group has property excess of loss catastrophe reinsurance cover in respect of UK exposures, with a retention of £125.0 million per event after lowering it from £220.0 million per event to £170.0 million per event in October 2010 and subsequently to £125.0 million per event in July 2011. This reinsurance includes a provision to reinstate coverage after a catastrophe claim is made. After any reinstatement an additional premium is payable, calculated at pro rata to the amount of reinsurance claimed. The Group has also purchased reinsurance for its motor business for an unlimited amount of indemnity in excess of a retained, indexed deductible of £3 million. This reinsurance has been renewed annually and all layers of protection are subject to unlimited free reinstatements of cover. The Group's international insurance business purchases liability excess of loss reinsurance with coverage up to the statutory minimum for Italy and Germany, as well as reinsurance to cover a portion of the entire portfolio of underwritten international policies (also known as "quota share reinsurance"). The Group is also a member of Pool Re, which offers reinsurance coverage for UK commercial claims arising from terrorist attacks.

The primary objectives of the Group's reinsurance programmes are to reduce the volatility of the Group's overall underwriting result, improve the stability of earnings for relevant business lines, transfer out of the Group risks that are outside of the Group's current risk appetite and, in its international businesses, protect capital through the strategic use of quota share reinsurance. Although reinsurance provides certain protection against the risk of catastrophic events, the occurrence of those events can still have a material impact on the Group's results due to both the size of the claims and the volume of claims the Group must manage. For more information about the Group's reinsurance policies and procedures, see Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Reinsurance*".

Claims inflation and PPOs

Over the past several years, the Group has experienced significant general inflation of claims (known as "social inflation") driven by higher levels of insurance awards associated with evolving attitudes of courts in the United Kingdom, legislated rises in compensation benefit levels, and more aggressive claimant activity. The impact of social inflation trends can be difficult to predict, but can be particularly pronounced in business lines with long-tailed claims, and as such has had a significant effect on bodily injury claims, causing the Group to increase reserves to match these inflation trends.

In addition, the UK insurance industry has experienced a significant increase in the award of PPOs to settle bodily injury claims, in which annually indexed payments are made periodically over several years or even the lifetime of the injured party, giving rise to longer-tailed liabilities compared to traditional

settlements. The increase in the award of PPOs has made the estimation of technical reserves increasingly complex and uncertain due to the increased range of assumptions required, such as the future propensity of such settlement methods, estimated rates of inflation, estimated mortality trends for impaired lives, payment patterns, investment income and the impact of reinsurance recoveries which will occur many years into the future with a resultant increase in the associated credit or other non-payment risk. PPO awards result in only a portion of the cash value of the claim being paid at settlement, with the remainder being paid over several years or the lifetime of the injured party. However, the expense associated with PPO awards is recognised based on the terms of the settlement and the assumed duration of the payment period, with a current assumed discount rate of 4.5% applied. As at 30 June 2012, the Group had experienced 73 PPO awards in total since settling its first claim in July 2008 and had further reserved for an additional 160 claims it expected to settle as PPOs. The Group believes reserves for PPO claims will represent an increasing proportion of its reserves in the future.

Claims development

The table below presents a reconciliation of claims reserves for the Group's total business, including run-off activities, for the six months ended 30 June 2012 as well as each of the three years ended 31 December 2011, 2010, and 2009.

	Six months ended 30 June 2012	Year ended 31 December		
		2011	2010	2009
		(£ millions)		
Gross				
Gross insurance liabilities at beginning of period/year	6,411.2	6,867.2	5,841.8	5,524.4
Incurred claims and claims expense				
Increase in liabilities arising from current period/year claims	1,589.9	3,345.3	4,453.4	4,331.9
(Decrease)/increase in liabilities arising from prior periods/years claims	(104.4)	(209.9)	486.4	(63.3)
Total increase in liabilities from current and prior periods/years	**1,485.5**	**3,135.4**	**4,939.8**	**4,268.6**
Net foreign exchange differences	(17.7)	(21.9)	(3.8)	(29.2)
Claim payments				
Cash paid for claims settled in the current period/year	(454.8)	(1,571.3)	(2,106.5)	(2,088.4)
Cash paid for claims settled in prior periods/years	(1,020.0)	(1,976.4)	(1,800.5)	(1,721.6)
Disposals	—	—	—	(136.1)
Total cash paid for claims settled in the period/year	**(1,474.8)**	**(3,547.7)**	**(3,907.0)**	**(3,946.1)**
Movement in liability adequacy provision	8.2	(21.8)	(3.6)	24.1
Gross insurance liabilities at end of period/year	**6,412.4**	**6,411.2**	**6,867.2**	**5,841.8**
Net of reinsurance				
Net insurance liabilities at beginning of period/year	5,811.3	6,336.4	5,463.1	5,166.3
Incurred claims and claims expense				
Increase in net liabilities arising from current period/year claims	1,473.3	3,210.9	4,348.3	4,287.6
(Decrease)/increase in net liabilities arising from prior periods/years claims	(258.4)	(227.1)	285.0	(125.1)
Total increase in net liabilities arising from current and prior periods/years	**1,214.9**	**2,983.8**	**4,633.3**	**4,162.5**
Net foreign exchange differences	(14.9)	(21.1)	(2.8)	(27.7)
Claim payments				
Cash paid for claims settled in the current period/year	(436.0)	(1,527.0)	(1,981.4)	(2,063.6)
Cash paid for claims settled in prior periods/years	(982.0)	(1,939.0)	(1,772.2)	(1,669.3)
Disposals	—	—	—	(129.2)
Total cash paid for claims settled in the period/year	**(1,418.0)**	**(3,466.0)**	**(3,753.6)**	**(3,862.1)**
Movement in liability adequacy provision	8.2	(21.8)	(3.6)	24.1
Net insurance liabilities at end of period/year	**5,601.5**	**5,811.3**	**6,336.4**	**5,463.1**

The composition of total booked claims reserves, excluding £0.2 billion of loss adjustment expenses and net of reinsurance, as at 31 December 2011 was: 36% personal motor bodily injury large claims (which the Group defines as claims with incurred costs greater than £120,000, including PPOs); 26% personal motor bodily injury small claims (which the Group defines as claims with incurred costs up to £120,000); 10% personal motor non-injury claims; 10% commercial claims (excluding latent claims); 8% international claims; 7% home claims; 2% rescue and other personal lines claims; and 1% latent claims.

Reserve releases

There are several elements to the Group's prior year reserve releases, such as release of margin, claims transformation actions and refinement of the Group's overall reserving strategy. The Group reserves with a margin above the actuarial best estimate to allow for reserving variability and releases this margin from prior year reserves as claims under those accident years develop. On a stable portfolio, reserving and then releasing under this strategy should be broadly neutral to the Group's profit, as the Group has reinstated the margin on current accident year business. From 2011, the Group began to recognise benefits from its claims transformation programme, leading to greater confidence in claims estimation, particularly with respect to motor insurance. Partly as a result of this, the Group released additional reserves relating to its motor insurance business in 2011 and the first half of 2012. In addition, the Group's reserving for its motor, commercial and international businesses has proved conservative over a number of years, and within its motor business, the Group is currently experiencing lower rates of inflation on small bodily injury claims than its rate of increases in motor reserves. The Group expects reserve releases to continue to contribute significantly to its operating profit going forward, although it does not expect to continue to release reserves at the level experienced in the first half of 2012.

In the first half of 2012, the Group recognised £228.4 million of prior year reserve releases for its ongoing business, consisting of releases across all business segments. The largest were in the Group's motor business, partly attributable to benefits from the Group's claims transformation programme, and in its commercial businesses, reflecting conservatism in initial reserving levels. There were also some prior year reserve releases in the Group's run-off business, the majority of the benefit of which went to its distribution partners under profit-sharing arrangements. In 2011, the Group had £188.8 million of prior year reserve releases for its ongoing business. Within those prior year reserve releases, there were two specific and unordinary items. The first was an increase in reserves relating to the Group's home insurance business attributable to late reported weather claims from the unusually cold weather in 2010. The second was the Group's rescue and other personal lines business reserve release, which related primarily to the Group's historical PPI business, that effectively accrued to its distribution partners. The Group did not experience a net release of prior year reserves in 2010, and recorded a net release of prior year reserves of £81.3 million in 2009 despite increasing reserves within its motor business by £95.5 million.

The Group presents its reserve releases and increases net of reinsurance. The table below presents the movements in prior year claims releases/(increases) net of reinsurance for the Group's ongoing business at a segmental level for the six months ended 30 June 2012 as well as the three years ended 31 December 2011, 2010, and 2009.

	Six months ended 30 June		Year ended 31 December		
	2012	2011	2011	2010	2009
	(£ millions)				
Claims releases/(increases) net of reinsurance					
Motor	108.5	54.5	138.2	(398.1)	(95.5)
Home	29.2	(55.8)	(48.5)	69.0	42.1
Rescue and other personal lines	12.7	24.7	52.8	38.5	24.9
Commercial	58.5	31.7	38.4	60.3	54.4
International	19.5	14.4	7.9	43.6	55.5
Total ongoing operations[1]	**228.4**	**69.5**	**188.8**	**(186.7)**	**81.4**

(1) Claims releases/(increases) net of reinsurance for the Group's total business, including run-off activities, as disclosed in the table on claims development above, were £258.4 million and £98.7 million for the six months ended 30 June 2012 and 2011, respectively, and £227.1 million, £(285.0) million and £125.1 million for the years ended 31 December 2011, 2010 and 2009, respectively.

Investment portfolio

The Group aims to manage its portfolio to maximise return relative to the Group's risk appetite and to serve as a stable income generator while providing a match to the Group's technical reserves and liquidity needs. The Group's net investment return is affected by general macroeconomic and financial market conditions and factors that affect the value and return on investments, such as changes in interest rates and credit spreads. As the Group's investment return is a significant contributor to the Group's profitability in any given year, these risks can affect the Group's financial results. The Group's UK investment portfolio

holds predominantly assets denominated in pounds sterling, but also includes a portion of fixed income assets denominated in US dollars and euros in order to provide greater investment diversification. US dollar denominated assets are hedged back to pounds sterling. The Group hedges euro and US dollar denominated bonds held within the investment portfolio through forward foreign exchange contracts, normally for a duration of 90 days.

As the majority of the Group's liabilities are short-tailed, fixed income investment constitutes a major part of the investment portfolio. A large portion of the portfolio consists of cash, gilts and other bonds. However, in response to the increase in PPO awards, which give rise to longer-tailed liabilities, the Group plans to use derivatives and additional asset classes such as commercial property to more closely match the longer-term duration of those liabilities.

The Group's overall investment portfolio consists of three primary individual portfolios, the UK core portfolio, which covers the Group's UK business (other than its business with TPF which is currently being run off and held as a separate portfolio, see Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Run-off businesses*"); and its euro-denominated international portfolios, which covers the Group's Italian and German insurance businesses. In the first half of 2012, the Group's high holdings of cash, particularly supporting the TPF portfolio, resulted in lower yields. During the same period, the Group's portfolio restructuring actions decreased its exposure to sovereign bonds and increased its exposure to US corporate bonds as well as caused the Group to exit UCITs which, together with sales of sovereign bonds, resulted in higher realised gains compared with previous periods. For a detailed discussion of the Group's portfolio assets, see "*—Investment assets*", and for a discussion of the Group's investment strategy, see Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Investments*".

Separation from the RBS Group

The Group has taken a number of actions as part of its separation from the RBS Group aimed at separating and improving its operations and systems as well as rationalising and migrating certain assets and employees. Since 1 July 2012, the Group has been operating on a substantially standalone basis from the RBS Group, with independent corporate functions and governance following the completion of a number of separation initiatives, including launching a new corporate identity, building standalone IT applications, confirming further senior management appointments and a new independent chairman, agreeing and issuing new terms and conditions for staff, and implementing new HR systems.

As a result of these separation actions, the Group incurred restructuring and one-off costs of £108.7 million during the six months ended 30 June 2012. The Group currently estimates additional restructuring and one-off costs to be in the region of £60 million in the second half of 2012, before any applicable tax deduction. This does not include the estimated £100 million costs expected to be incurred in 2013 and 2014 relating to migration of the Group's IT services referred to below. The primary separation cost items include:

- ***Operations and systems separation:*** Beginning in 2011, the Group commenced a major project to separate its operations from the RBS Group. The project encompasses the transfer, replacement or replication of the essential assets, services, processes and governance, which were previously provided by the RBS Group, some of which are currently provided under the TSA. Customer facing operations were already largely separate from the RBS Group. Therefore, the outstanding principal initial separation requirements involved head office and controlled functions, including finance, risk, human resources, company secretariat, legal, internal audit, corporate communications, IT, property and logistics, and purchasing functions, while IT infrastructure and certain other limited services will continue to be provided by the RBS Group under the TSA until a date specified in the TSA, being in the first instance, no later that 36 months after Admission. The contracted costs under the TSA are initially expected to be approximately £95.0 million per year, and those costs will reduce as services gradually migrate to the Group. Following completion of the IT migration and the end of the TSA period, the Group expects ongoing run-rate costs for network and hosting infrastructure to be broadly in line with the initial annual TSA expenditures. However, the actual amount and timing of these costs may be different to those expected. In the event that migration extends beyond the 36 months after Admission, the RBS Group is obliged to extend the service terms until completion of migration, subject to the payment of additional charges. See Part XVI: "*Additional Information—Material Contracts—Transitional Services Agreement*".

- ***Property leases:*** In preparation for divestment, the Group agreed to compensate the RBS Group for ongoing lease obligations in relation to certain properties that have been vacated by the Group as part of the site rationalisation programme. The Group made additional provisions for these lease obligations and as a result, a charge of £25.1 million was recognised during the six months ended 30 June 2012.
- ***Pensions:*** DL Insurance Services Limited ("**DLISL**") previously participated in the RBS Group Pension Fund. It ceased doing so on 31 May 2012. On 29 June 2012, DLISL entered into an arrangement with RBS plc, National Westminster Bank plc and the trustee of the RBS Group Pension Fund to settle the debt owed to the trustee of the RBS Group Pension Fund by DLISL on its withdrawal from the scheme, and to obtain a discharge from any further liability under the rules of the RBS Group Pension Fund and the scheme funding and employer debt legislation. Under the terms of this arrangement (a flexible apportionment arrangement), DLISL paid £31.3 million to the trustee of the RBS Group Pension Fund which was the debt that had arisen in relation to the benefits that had accrued to DLISL's own current and former employees. All remaining liabilities of DLISL in relation to the scheme were assumed equally by RBS plc and National Westminster Bank plc as continuing employers in the RBS Group Pension Fund.
- ***Other separation and divestment costs:*** In addition to the above items, the Group has incurred and expects to incur additional separation and divestment costs related to the Group's professional fees in relation to the Offer.

In addition to the separation items above, the Group will continue for a period of time to rely on the RBS Group for significant IT services, including IT infrastructure and communications, certain logistics services and certain other services. These services are provided for under the TSA between the Group and the RBS Group. In connection with the migration of the IT services to the Group during and at the end of the TSA period, the Group will be making a significant investment by 2014 in its own IT to prepare for and execute that migration, and expects to incur one-off migration costs in the region of £100 million, before any applicable tax deduction, approximately proportionately over 2013 and 2014. This amount does not include the estimated annual operating costs to be incurred under the TSA or other capital expenditure in relation to IT in the ordinary course of the Board's investment plans for the Group. The actual cost of the IT migration may, however, cost more than the Group expects. See "*Risk Factors—Risks Relating to the Group—The Group's operations support complex transactions and are highly dependent on the proper functioning of information technology and communication systems*". In the year ended 31 December 2011, RBS Group recharges represented 28.7% of the Group's cost base.

Cost and operational efficiency

At the end of 2009, the Group initiated a transformation plan encompassing a range of initiatives to address the underperformance of the business in 2010 and 2009. In addition to significant increases to the Group's reserves and improvements to the Group's pricing and claims management capabilities discussed above, the Group undertook a number of initiatives aimed at reducing its cost base and improving the overall performance of the business. The most significant of these initiatives were:

- ***Offshoring:*** Beginning in December 2009, the Group began moving selected low value, low risk back office functions offshore, reducing the number of staff in the United Kingdom as well as reducing overall headcount. By the end of 2011, the Group had successfully relocated over 400 full-time employee roles offshore and reduced overall Group full-time employees by 9%.
- ***Lean programme:*** Beginning in January 2010, the Group initiated a programme aimed at reforming its core management approach to service and cost savings. The goal of the programme is to develop a set of tools and techniques that focus each function of the Group on making continuous improvements to efficiency, customer service, and operations. By the end of 2011, the Group had completed implementation of the programme in its sales and service functions, achieving estimated efficiency gains of greater than 15% in those functions. The Group has since launched the programme in other functions and expects to roll it out across the organisation by 2014.
- ***Site rationalisation:*** At the beginning of 2010, the Group began reducing its number of operations centres, both in its personal lines and commercial lines businesses, from 34 at 1 January 2010 to 18 at 30 June 2012. The Group aims to exit up to a further three sites by the end of 2012 and to reduce the number of operating sites to 13 by 2014. The Group believes its site rationalisation programme

and a simplified organisational structure will help it achieve greater operational efficiency and improve its expense ratio.

In addition, the Group has recently launched the following cost reduction initiatives:

- ***Marketing and distribution:*** In connection with its strategy of further deepening customer relationships and attracting fewer but higher value customers, the Group will seek to remove unnecessary marketing and distribution costs and develop techniques that will improve customer conversion and retention.
- ***Administrative cost reduction initiatives:*** Beginning in 2012, the Group launched a series of further initiatives aimed at improving its overall organisational structure and design. In the first phase of this programme, the Group will focus on approximately 900 staff redundancies, which it plans to achieve through reducing costs and improving efficiency in the Group's sales, service and partnerships division, which has resulted in the proposed closure of the Group's site in Teesside, reducing costs in the Group's commercial insurance business' head office, and a reorganisation of IT application development and business testing functions in the Group's chief operating office. The Group will continue to evaluate its operations with the aim of taking what the Board believes is a clear opportunity to reduce cost and bureaucracy.

  The second phase of this programme will focus on removing management layers, overlap and duplication in management functions, streamlining accountabilities, and reshaping the Group's overall management structure. The Group will seek to leverage its new and improving IT systems to reduce costs related to HR, reduce customer acquisition costs through online platforms such as broker e-trading, and reduce and rationalise IT support teams in line with overall reductions in full-time employees. The Group intends to terminate small, non-strategic and resource intensive activities and reduce the use of external resources such as contractors, consultants and other professional services. The Group expects these cost reduction initiatives, and the removal of unnecessary distribution costs, will result in additional one-off and restructuring costs in the region of £100 million, and expects to incur a small portion of those costs in the second half of 2012, with the remainder to be incurred during 2013.

The Group is targeting a gross annual cost and claims handling savings of £100 million from the above initiatives by 2014. Implementation of these initiatives involves coordination of complex organisational changes. The actual amount and timing of these cost and claims savings may be different to those targeted.

The Group estimates that the combination of (i) the costs associated with its administrative cost reduction initiatives, (ii) separation costs, and (iii) IT migration costs to result in total restructuring and other one-off costs in the region of £180 million in the year ending 31 December 2012, £140 million in the year ending 31 December 2013, and £50 million in the year ending 31 December 2014. The Group expects to account for future one-off separation costs, IT migration costs and costs associated with its cost reduction initiatives in the restructuring and other one-off costs line item in its financial statements. The Group does not anticipate any restructuring and other one-off costs beyond 2014 in respect of those costs, however there remains a risk that actual costs could be higher and the period over which they are incurred could be longer. See Part II: "*Risk Factors—Risks relating to the Group—The Group faces a number of one-off or restructuring costs in connection with its separation from the RBS Group and new cost initiatives*".

Going forward, the Group intends to continue a programme of large but strategically focused investment in areas of distribution, pricing, claims, costs, and its commercial and international businesses over the next several years. Key investments in these areas may include new customer interaction systems designed to reduce the cost to acquire and service customers, new data systems for better integrating customer data throughout the Group's marketing, distribution and pricing systems, high capacity processing and storage systems, broker e-trading systems, and other restructuring and rationalising of the Group's operations.

Exited and run-off business

As part of its transformation plan and other restructuring activities to its business, beginning in 2009, the Group exited its fleet and taxi businesses and sold the interest in its Spanish business, Linea Directa, as well as its motorcycle business. The Group also placed its TPF business and NIG personal lines business into run-off. During the periods under review, the TPF, NIG personal lines, and Linea Directa businesses comprised the Group's run-off activities, and have been accounted for in the Group's operating loss from run-off activities line item. In the year ended 31 December 2009, these run-off activities together accounted for £1,119.5 million in gross written premium and an operating loss of £165.1 million, whereas in

the year ended 31 December 2011, the run-off activities accounted for £43.4 million in gross written premium and an operating loss of £23.9 million. By the six months ended 30 June 2012, the net contribution of these businesses had decreased to £4.1 million in gross written premiums and an operating profit of £1.2 million. Going forward, the Group does not expect to generate any significant gross written premium from its run-off activities, and expects that these activities will not have a material impact on the Group's results. The Group has recently agreed with TPF the level of final reserves to be retained by it in respect of the run off of remaining claims under TPF Policies and finalised certain other matters arising out of the expiration of the distribution arrangements. The agreement with TPF is not expected to be material in the context of the overall Group financial performance. Following the TPF reserve determination, the risks and rewards of the claims reserves have been transferred to the Group. The Group currently estimates that it will need to hold approximately £300 million of capital against the run-off businesses, which is expected to decrease over the run-off period.

The run-off category includes only the Linea Directa, TPF, and NIG personal lines businesses. Other impacts to the Group's financial information resulting from the transformation plan and separation from the RBS Group are reflected in restructuring and other one-off costs as well as in the results for the ongoing businesses.

Regulatory and legal developments

Changes to government regulation, legislation, and enforcement, as well as changes to attitudes of courts can require the Group to make significant changes to its reserves, pricing models and systems, and can have a material effect on its results of operations. While certain developments, such as the increasing claims awards and the increasing prevalence of PPOs, have already affected the Group's reserving and pricing during the periods under review, future developments with respect to motor bodily injury may continue to affect the Group. At the same time, new regulations with respect to capital adequacy and controls are being developed by the European Union, and these regulations will affect the Group's capital position and results (see Part IX: "*Regulatory Overview—Regulatory developments*").

While the Board cannot predict with certainty the effects that regulatory reforms may have on the Group, to help the Group assess and manage the likely impact of regulatory and legal developments and uncertainties in its business, the Group's policy has been to proactively engage in emerging regulatory developments by participating in industry lobbying and related consultation, and supporting the introduction of a coherent package of reforms. In addition, management of emerging regulatory and legal trends has focused on several different outcomes, some of which may have a positive financial impact, such as removal of success fees, and changes to civil procedure rules, while others may have a negative financial impact, such as a ban on referral fees, changes to judicial guidelines permitting increases to general damages, and qualified one-way cost shifting. The Group has the capability to adapt its claims and pricing models in response to regulatory changes and has modelled several different scenarios with regard to regulatory trends in order to minimise the overall impact and take advantage of emerging opportunities. For example, the Group expects to re-rate its motor book without gender as a rating factor ahead of the effective date for the Gender Directive regulatory changes. The Board believes the Group's scale advantage should afford it a competitive advantage when it comes to responding to regulatory reforms.

The following discusses those regulatory and legal developments that the Board believes may have a significant impact on the Group's future results of operations:

Ogden discount rate

A change in the "Ogden discount rate", which is the discount rate set by the UK government and used by courts to calculate lump sum awards in bodily injury cases, would impact all relevant claims settled after that date, regardless of whether the insurance to which the claim relates was priced on that basis or not. A reduction in the Ogden discount rate would have the effect of increasing the present value of lump sum awards, thereby increasing the amount the Group would need to pay to settle certain claims. The current discount rate is 2.5% a year, and was established in 2001 for England, Wales, and Northern Ireland and in 2002 for Scotland. However the current low interest rate environment has given rise to uncertainty around the future Ogden discount rate, and on 1 August 2012, the Ministry of Justice, the Scottish Government and the Department of Justice, Northern Ireland, released a paper soliciting views on changes to the methodology for setting the Ogden discount rate. From 2010, the Group has calculated its estimated reserve based on an assumed discount rate of 1.5% in recognition of that uncertainty and its best expectations of the future rate to be applied. A reduction in the discount rate to 1.0% would result in an

increase in net reserves by approximately £85 million (above the current reserve estimate based on a 1.5% discount rate); a reduction to 0.5% would result in an increase of approximately £190 million; and a reduction to 0.0% would result in an increase of approximately £310 million. See "*Risk Factors—Risks Relating to the Group—A sustained period of low interest rates or interest rate volatility could adversely affect claims settlements*".

Civil litigation costs reform in England and Wales

Legislation and regulation recently proposed in the United Kingdom, including the enactment of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 ("**LASPO**") and other reforms to costs in the English civil litigation system proposed by Lord Justice Jackson, including a 10% increase in general damages, could affect the Group's other income and claims-related costs. Provisions such as a reduction in fixed fees for filing legal claims as well as the removal of "after the event" legal expenses insurance and conditional fee arrangements or "success fees" as prescribed under LASPO could reduce the amount the Group must pay to settle bodily injury claims, which could positively affect its loss ratio, and may reduce the Group's legal and administrative costs of settling and litigating claims, which could positively affect its expense ratio. At the same time, other provisions such as the banning of referral fees would result in a substantial decrease in the income the Group generates through solicitor referrals while a 10% increase in general damages would offset a significant portion of the gains from reforms to legal fees. See Part IX: "*Regulatory Overview—Regulatory developments—Civil litigation costs reform in England and Wales*" for further information on these reforms.

Taken together, the Group currently believes that these proposed reforms, if implemented in a coordinated manner, should have a broadly neutral effect on the results of the Group in the medium term although the short term impact of some reforms (such as the banning of referral fees) may have an adverse effect on the Group's results before the benefits of other reforms (such as the reduction in fixed legal fees) are realised by the Group.

Examples of the proposed changes which are adverse to the Group include the proposed 10% increase in general damages referred to above and the proposed ban on referral fees. The Group generated £11.0 million in solicitor referral fee income from its ongoing operations during the six months ended 30 June 2012, and £27.9 million, £39.4 million, and £31.0 million during the years ended 31 December 2011, 2010, and 2009, respectively.

Conversely, reforms such as the reduction in fixed legal fees as well as the removal of "after the event" legal expenses insurance and success fees would have the effect of lowering claims costs, and could offset much or all of the negative impacts described above, although the benefits to the Group of any reduction in fixed legal fees from £1,200 per claim are uncertain as the revised fixed fee amount has yet to be confirmed.

However, if certain of these reforms are adopted on a piecemeal or uncoordinated basis, these reforms could have an adverse effect on the Group's results.

A specific recent example of this, which may have an incremental adverse impact on the Group's results in the short term, is the decision in July 2012 of the Court of Appeal in *Simmons v. Castle* ([2012] EWCA Civ 1039). The Group had previously anticipated that a 10% increase in general damages, as recommended by Lord Justice Jackson, would apply to new claims commenced after 1 April 2013 but with certain other offsetting measures to be implemented by LASPO coming into effect at or around the same time. However, the Court's decision implemented a 10% increase in general damages with effect from 1 April 2013 but applied it to all claims decided after that date, irrespective of when the claim was made. As a result, claimants for recoverable claims commenced before 1 April 2013 but settled or decided after 1 April 2013 would be entitled to recover a success fee and after-the-event premiums and additionally a 10% increase in the amount of general damages.

There is currently uncertainty arising from the Court of Appeal's decision in *Simmons v. Castle* in July 2012 and a subsequent hearing on 25 September 2012, following applications by the ABI to the Court of Appeal for it to reconsider its decision. The outcome of the recent hearing is pending as at the date of this Prospectus and, as such, the impact on cost of claims for the industry is unclear. If the Court declines to amend its July decision, and assuming its decision is handed down in the near future, the Group currently estimates that this could result in an adverse pre-tax impact in the region of approximately £30 million to £45 million to the Group's results in 2012, the majority of which may be recognised in the third quarter of 2012. If the Court reverses its original decision, this impact will not arise, although it is also possible that

the Court may implement a compromise position, which would result in a lesser impact. Given the current uncertainty, the above estimates do not include mitigating actions, if any, that may be available to the Group.

The ultimate impact of these initiatives remains uncertain, however, and uncoordinated adoption of the various reforms could lead to short-term adverse impacts before the benefits of the entire program emerge, or longer-term impacts if the reforms are not implemented as anticipated. Regardless of outcome, the Group does not focus on regulatory reforms as a substitute for other cost saving and efficiency efforts.

OFT motor insurance market study

The OFT, together with the UK Competition Commission, has conducted several market studies and investigations on the insurance industry in recent years. For example, the OFT published a report on its market study into private motor insurance and related goods and services on 31 May 2012, which focused on insurers' provision of third-party repair and replacement vehicles to claimants. Currently, revenue generated from vehicle hire replacement referrals partially offsets the cost of providing a non-fault policy holder with a replacement vehicle. On 28 September 2012, the OFT confirmed its May decision to refer the matter to the UK Competition Commission. The Board cannot estimate with any certainty the effect that this decision may have on the Group. See Part IX: "*Regulatory Overview—Regulatory developments*" for further information.

Solvency II

As part of the transition to Solvency II, the Group will be required to change the model used to determine its regulatory capital requirements, both in relation to U K Insurance, its main UK regulated general insurance entity, its insurance operations in Germany and Italy and its small life insurance business (see Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Capital Resources*" for more information on its Solvency II preparation). The Group's implementation of Solvency II could require it to strengthen its solvency capital position, which could adversely affect its results of operations. The Solvency II regime is also expected to require changes to the Group's business operations, which could result in increases to its operating expenses and therefore negatively affect its expense ratio. While the overall intentions and process for implementing Solvency II are known, the future landscape of EU solvency regulation is still evolving, and the precise interpretation of the rules is still being developed, and therefore the overall effect upon the Group remains uncertain.

Changes in economic environment

The Group's results are affected by conditions in the global economy, in the United Kingdom, Europe, the US and elsewhere around the world (see Part II: "*Risk Factors—Risks relating to the Group—Difficult conditions in the global, European or UK economy may have a material adverse effect on the Group's business, results and financial condition*"). Since the start of the global financial crisis in 2008, the global economy has been experiencing a period of significant turbulence. The United Kingdom is currently experiencing little or no economic growth, and many forecasts predict only stagnant or modest levels of GDP growth in the Group's other markets of Italy and Germany over the near to medium term. In the current economic downturn, characterised by higher unemployment, lower household income, lower corporate earnings, lower business investment, and lower consumer spending, the demand for the Group's insurance products has been and could continue to be adversely affected. In addition, economic conditions may cause the Group to experience an elevated incidence or cost of claims, including higher claims inflation or fraudulent claims, as well as changes in accident rates, any of which could affect the current and future profitability of its business. A prolonged economic downturn could result in lower sales figures in the future as consumers may choose to reduce their insurance cover or purchases, defer buying or stop buying insurance altogether.

As part of the current economic downturn, the fixed-income markets have experienced an extended period of volatility (increasing in the second half of 2011 and 2012), which has negatively impacted market liquidity conditions. Continuing market volatility and continued low interest rates have, and may continue to have, an adverse effect on the Group's investment portfolio. Even in the absence of a downturn in the global economy, the Group is exposed to risk of loss due to the impact of market volatility on its investment portfolio, in circumstances where the Group considers it necessary or appropriate to sell fixed-income assets prior to maturity.

Instalment income

Certain of the Group's insurance policies are sold to customers on an instalment basis, where outstanding premiums are settled by a series of instalment payments. The sale of insurance on an instalment basis generates instalment income for the Group, which consists of the amount paid by policyholders in excess of the premium that would have been paid had the policyholder settled the full amount of the premium at the beginning of the policy, and is recognised using an effective interest rate method over the term of the policy as interest income. In the year ended 31 December 2011, approximately 69% of instalment income was generated in the Group's motor business, with a majority of the remainder arising in the home business. Rates of payment by instalment income within the Group's own brands tends to be largely consistent, with 52.5%, 53.3% and 53.5% of own brand motor policyholders and 45.4%, 46.5% and 48.6% of own brand home policyholders paying by instalments in each of the years ended 31 December 2011, 2010 and 2009, respectively. Customers choosing to pay for motor insurance on an instalment basis tend to correlate with slightly higher risk, and as a result the Group takes this into account when it sets its reserves.

Distribution partners

The Group offers many of its core products, including products in each of its business segments, through several partner brands under various distribution agreements. The Group believes these distribution arrangements allow it to reach a broader customer base and access certain key customer segments. The Group's principal partner brands in terms of contribution to gross written premium include Prudential, RBS/NatWest, Nationwide, and Sainsbury's. Partner brands comprise a significant amount of gross written premium for the Group's home business, and its Fiat partnership was a significant contributor to gross written premium growth within the international business. Partner brands also comprise a significant amount of in-force policies for the Group's rescue and other personal lines business, particularly with respect to the RBS/NatWest brand.

During the periods under review, the Group entered into or renewed several distribution agreements as well as exited certain others, the most significant of which were:

- ***Lloyds Banking Group:*** On 22 December 2010, the Group terminated its partnership with Lloyds, through which it had written motor insurance;
- ***Sainsbury's:*** On 1 June 2011, the Group launched a distribution partnership with Sainsbury's for a minimum term of five years to offer insurance for motor and rescue products, and on 31 January 2012, launched a distribution agreement for a minimum term of five years to offer home insurance;
- ***Fiat:*** On 1 October 2010, the Group launched a distribution partnership with Fiat (provided through FGA Capital, the financial services business of Fiat Group Auto), renewable on an annual basis, to offer motor insurance to Fiat customers in Italy; and
- ***RBS/NatWest:*** On 21 September 2012, the Group renewed and expanded its distribution partnership with RBS/NatWest for a duration of five years, which allows the Group to continue to offer travel, rescue, and certain home products as part of packaged bank accounts as well as standalone home, motor, travel, rescue and other insurance; and
- ***Nationwide:*** On 11 June 2012, the Group renewed its distribution partnership with Nationwide to offer home insurance (this agreement covers the period from 22 December 2011 to 31 December 2015) as well as provide travel insurance packaged with Nationwide bank accounts.

In exchange for the additional customers and premium generated by these distribution arrangements, the Group typically pays a fixed percentage of the written business to its partners plus a share of the profit or loss generated from the distribution business. The Group recognises these amounts paid to partners in its commission expenses. The profit and loss sharing element of the partnerships includes the effects of any increases or releases to Group reserves relating to that business. As a result, a reserve release will give rise to an increase in commission expenses as the partner's portion of the release is paid through the profit sharing element of the partnership agreement.

DESCRIPTION OF KEY LINE ITEMS

Gross written premium

Gross written premium represents the total premiums expected to be received by the Group over the life of insurance contracts written during the period, before deducting the cost of premiums in relation to risk passed on to reinsurers.

Net earned premium

Net earned premium represents the premiums received by the Group (net of increases or decreases in the provision for unearned premiums) for the insurance risk held after deducting the cost of premiums in relation to risk passed on to reinsurers.

Net insurance claims

Net insurance claims represent total demands placed by policyholders for indemnity under insurance contracts or policies in force during the year together with the handling costs of the claims made in the period, less insurance claims that will be met by reinsurers as a result of the Group's reinsurance contracts.

Commission expenses

Commission expenses represent amounts due to agents who bring business to the Group as well as charges for the share of profits or recoveries for losses due to or from partners under profit participation agreements. Agreements with partners typically include provisions for the partner to participate in profits or losses generated by the business written with the partner's customers on the basis of the determined loss ratio.

Other operating expenses

Other operating expenses historically consisted of: marketing costs; staff costs; depreciation of fixed assets, and amortisation and impairment of intangible fixed assets (including goodwill); management fees payable to the RBS Group for services provided to the Group; and other operating expenses. From 1 July 2012, the Group will no longer incur management fees payable to the RBS Group for services provided to the Group, and will instead include fees under the TSA and other stand-alone costs in other operating expenses.

All costs are posted to the relevant company of the Group and booked to cost centres covering various different managed functions. The transactions in each cost centre are then allocated to segments based on cost drivers specific to that centre. Where the activities of the cost centre fall completely into a segment, all of the costs are posted directly. Where a cost centre's activities relate to more than one category, however, (e.g. central costs for corporate activities) an allocation is made based on one or more metrics, such as gross written premium, in-force policies, number of claims, number of employees, or another appropriate metric. The Group may change the allocation of other operating expenses among the segments as it continues to refine the cost drivers for such allocation.

At the same time as the allocation of operating expenses is made between business segments, a transfer of a proportion of the relevant directly attributable operating expenses is transferred to the claims line to reflect the cost of handling claims. This allocation is divided between the segments on the basis of the net earned premium.

Investment return

Investment return comprises interest income on debt securities, dividend income from equities (which ceased in 2009 following the Group's disposal of its equity investments), other investment fund income, cash and cash equivalent interest income, property income, net realised gains or losses from the sale of debt and equity securities, impairments to available-for-sale financial assets, and net unrealised gains or losses from derivatives and investment property. Investment return for UK businesses (excluding run-off businesses) are delivered from a centrally controlled pool of assets and are allocated to segmental performance on the basis of the comparative level of technical reserves in each period. Investment return for the Group's international business and its run-off activities is delivered from their respective investment portfolios.

Instalment income and other operating income

Instalment income is the amount paid by policyholders in excess of the premium that would have been paid had the policyholder settled the full amount of the premium at the beginning of the policy as a consequence of the policyholders taking an instalment based payment option. Instalment income for 2010 and 2009 is shown net of an RBS Group recharge.

Other operating income consists of solicitor referral fee income, vehicle replacement referral fee income, revenue from vehicle recovery and repair services, fee income from insurance intermediary services, and other income such as salvage income. The Group's ongoing operations have also derived other operating income associated with the recharge of applicable expenses to TPF. This income is included within the other operating income for ongoing operations and is recorded as an expense by the run-off segment within the "Instalment income and other operating income" line item.

CURRENT TRADING

Trading update

Overall trading to date in the second half of the financial year has been in line with the underlying trends experienced in the six months ended 30 June 2012.

While the Group's primary markets remain competitive, in-force policies and gross written premium remain broadly stable. Claims trends continue to be favourable overall, and the Group expects to make further reserve releases partly attributable to its ongoing claims transformation programme. The Group expects to make progress in reducing its expense ratio from its ongoing business in the second half of 2012. While investment yields are subject to downward pressure in the current low interest rate environment, leading to some reduction in investment income, the Group has made good progress in developing its investment strategy and has increased its investment grade fixed income investments to around its target level. The Group does not expect to see the same benefit from realised investment gains as experienced in the six months ended 30 June 2012, which arose primarily from reallocating investment portfolios as the strategy has been implemented.

Regulatory developments

Regulatory developments remain a key area of focus for the Group and the industry as a whole. The Group continues to believe that the civil litigation costs reforms that are expected to come into effect on 1 April 2013, if implemented in a coordinated manner, should have a broadly neutral effect on the results of the Group in the medium term (see "*—Key Factors Affecting Results of Operations—Regulatory and legal developments—Civil litigation costs reform in England and Wales*"). There is currently uncertainty arising from the Court of Appeal's decision in *Simmons v. Castle* in July 2012 and a subsequent hearing on 25 September 2012, following applications by the ABI to the Court of Appeal for it to reconsider its decision. The outcome of the recent hearing is pending as at the date of this Prospectus and, as such, the impact on cost of claims for the industry is unclear. If the Court declines to amend its July decision, and assuming its decision is handed down in the near future, the Group currently estimates that this could result in an adverse pre-tax impact in the region of approximately £30 million to £45 million to the Group's results in 2012, the majority of which may be recognised in the third quarter of 2012. If the Court reverses its original decision, this impact will not arise, although it is also possible that the Court may implement a compromise position, which would result in a lesser impact. Given the current uncertainty, the above estimates do not include mitigating actions, if any, that may be available to the Group. Even if the Court declines to amend its July decision, it is not anticipated that the outcome will impact the Board's decision in determining, in accordance with its stated dividend policy, the amount of any 2012 final dividend.

Separation update

The Group reached agreement with RBS Group in September 2012 for an arm's-length, five year distribution agreement for the continued provision of general insurance products post divestment.

The Company declared and paid a further interim dividend of £200 million to the RBS Group on 3 September 2012. This represents the final dividend prior to the Offer.

RESULTS OF OPERATIONS

Group results of operations

The Group's results of operations in this discussion are different in their presentation from the combined income statements in the Group's historical financial information included in Part XIII: "*Financial Information*" of this prospectus. The Board believes the financial information below, in which the Group's ongoing operations have been presented separate from its run-off and restructuring activities, better represent the underlying performance of the ongoing business and are consistent with how the Group has historically evaluated the business (see Note 4 to the Group's historical financial information included in Part XIII: "*Financial Information*") and how the Group intends to report its results of operations in the future.

Six months ended 30 June 2012 and 2011

The table below presents Group's results of operations for the six months ended 30 June 2012 and 2011.

	Six months ended 30 June	
	2012	2011
	(£ millions)	
Ongoing operations[1]		
Gross written premium	2,058.4	2,093.2
Net earned premium	1,860.8	1,943.7
Net insurance claims	(1,253.1)	(1,442.9)
Commission expenses	(155.9)	(150.2)
Other operating expenses	(471.8)	(400.8)
Underwriting result	**(20.0)**	**(50.2)**
Investment return	145.4	125.5
Instalment and other operating income	98.8	134.2
Operating profit/(loss)	**224.2**	**209.5**
Total operations		
Operating profit/(loss) from ongoing operations	224.2	209.5
Operating profit/(loss) from run-off activities	1.2	(12.4)
Restructuring and other one-off costs	(108.7)	(9.8)
Finance costs	(10.2)	(1.4)
Gain recognised on disposal of subsidiary and joint venture	—	1.6
Profit/(loss) before tax	**106.5**	**187.5**
Tax (charge)/credit	(23.7)	(45.3)
Profit/(loss) for the period	**82.8**	**142.2**

(1) Excludes run-off activities and restructuring and other one-off costs.

Gross written premium—ongoing

Gross written premium for the Group's ongoing business in the first half of 2012 remained broadly stable with the first half of 2011 and consistent with the overall trends experienced in in-force policies throughout 2011 and the first half of 2012. Modest declines in gross written premium for the Group's motor and home businesses were partially offset by increases in the Group's rescue and other personal lines businesses while gross written premium for the Group's commercial and international businesses remained flat compared with the first half of 2011. As a result, gross written premium for the Group's ongoing business for the six months ended 30 June 2012 was £2,058.4 million, a decrease of £34.8 million or 1.7% from £2,093.2 million for the six months ended 30 June 2011.

Net earned premium—ongoing

Changes in net earned premium from the Group's ongoing business reflected an increase to reinsurance premium ceded from £114.5 million in the first half of 2011 to £161.3 million in the first half of 2012 as a result of a decrease gross written premium and a higher level of reinsurance premium ceded. Net earned

premium from the Group's ongoing business for the six months ended 30 June 2012 was £1,860.8 million, a decrease of £82.9 million or 4.3% from £1,943.7 million for the six months ended 30 June 2011.

Net insurance claims—ongoing

Net insurance claims from the Group's ongoing business benefitted from a release to prior year claims reserves of £228.4 million in the first half of 2012. The release applied to all business segments, though was particularly concentrated in the Group's motor and commercial businesses, and was attributable to benefits arising from the Group's claims transformation programme. The benefits to ongoing net insurance claims from the reserve release were partially offset by approximately £90 million in claims in the Group's home business following the wettest April to June period on record in the United Kingdom. As a result, net insurance claims for the Group's ongoing business for the six months ended 30 June 2012 were £1,253.1 million, a decrease of £189.8 million or 13.2% from £1,442.9 million for the six months ended 30 June 2011. This decrease helped improve the Group's loss ratio from its ongoing business for the six months ended 30 June 2012 to 67.3% compared with 74.2% for the six months ended 30 June 2011, despite the adverse weather experienced in the first half of 2012.

Commission expenses—ongoing

The increase to the Group's commission expenses from ongoing business in the first half of 2012 was largely due to reserve releases during the period, which resulted in additional profit to the Group's partners and therefore an increase to commission expenses. Commission expenses from the Group's ongoing operations for the six months ended 30 June 2012 were £155.9 million, an increase of £5.7 million or 3.8% from £150.2 million for the six months ended 30 June 2011.

Other operating expenses—ongoing

Other operating expenses for the Group's ongoing business in the first half of 2012 were impacted by temporary increases in central overhead costs relating to the establishment of the Group's separate corporate functions, higher management recharges from the RBS Group of £16.4 million and accelerated expenditures on marketing activities. As a result of these impacts, other operating expenses from the Group's ongoing business for the six months ended 30 June 2012 were £471.8 million, an increase of £71.0 million or 17.7% from £400.8 million for the six months ended 30 June 2011.

Investment return—ongoing

The table below presents a breakdown of the Group's investment return from its ongoing operations for the six months ended 30 June 2012 and 2011.

	Six months ended 30 June	
	2012	**2011**
	(£ millions)	
Ongoing investment income		
Interest income on debt securities	81.2	95.2
Other investment fund income	2.9	3.3
Cash and cash equivalent interest income	9.7	6.6
Property income	3.5	3.6
Total	**97.3**	**108.7**
Ongoing net realised gains		
Debt	24.6	16.7
Other	22.5	—
Derivatives	1.8	—
Net unrealised (losses)/gains from derivatives	(0.8)	0.1
Total investment return—ongoing	**145.4**	**125.5**

The Group's primary ongoing investment income consists of interest earned on debt securities, which decreased from £95.2 million for the six months ended 30 June 2011 to £81.2 million for the six months ended 30 June 2012, a decrease of £14.0 million or 14.7%, as a result of lower market yields on debt securities coupled with a decrease in the Group's total debt securities held, thereby affecting the total mix

of debt interest to cash interest. Furthermore, interest income from the Group's cash and cash equivalents increased from £6.6 million in the six months ended 30 June 2011 to £9.7 million in the six months ended 30 June 2012 due to high holdings of cash in the first half of 2012.

Declines in ongoing investment income were more than offset by increases in net realised gains from the sale of debt securities and other investment funds as a result of portfolio restructuring actions in the first half of 2012. The portfolio restructuring consisted largely of sales of sovereign bonds and an exit from UCIT investments, with the proceeds invested primarily in corporate bonds, and in particular US corporate bonds. Net realised gains from the sale of debt securities increased from £16.7 million in the six months ended 30 June 2011 to £24.6 million in the six months ended 30 June 2012. In addition, the Group realised gains from the sale of other investment funds of £22.5 million in the year ended 30 June 2012.

As a result of these offsetting factors, overall investment return from ongoing operations for the six months ended 30 June 2012 was £145.4 million, an increase £19.9 million or 15.9% from £125.5 million for the six months ended 30 June 2011.

Instalment and other operating income—ongoing

The tables below present a breakdown of the Group's instalment and other operating income from its ongoing operations for the six months ended 30 June 2012 and 2011.

	Six months ended 30 June	
	2012	2011
	(£ millions)	
Ongoing instalment income		
Motor	44.0	51.2
Home	12.7	13.4
Other ongoing	5.4	5.4
Total instalment income—ongoing	**62.1**	**70.0**
Ongoing other operating income		
Solicitor referral fee income	11.0	14.6
Vehicle replacement referral fee income	8.5	10.9
Revenue from vehicle recovery and repair service	14.8	16.4
Fee income from insurance intermediary services	0.7	2.5
Other	2.0	1.9
Other operating income from third parties	**37.0**	**46.3**
Less: Other operating income earned by run-off activities	(0.3)	(0.1)
Expenses recharged to run-off activities by ongoing segments	—	18.0
Total other operating income—ongoing	**36.7**	**64.2**
Total instalments income and other operating income—ongoing	**98.8**	**134.2**

Instalment income is recognised as interest income earned on the policies paid by instalments, while other operating income consists mainly of solicitor and vehicle replacement referral fee income, revenue from vehicle recovery and repair services, and fee income from insurance intermediary services. Other operating income also captured certain expenses incurred by the Group that were recharged to run-off activities from the Group's ongoing business segments. In the six months ended 30 June 2011, expenses recharged to run-off activities and recognised as other operating income were £17.9 million, while in the six months ended 30 June 2012, expenses recharged to run-off activities resulted in a very small adjustment of £0.3 million. As run-off activities continue to wind down, the Group does not expect to continue recognising significant recharges of expenses in its ongoing other operating income.

Instalment and other operating income from the Group's ongoing operations for the six months ended 30 June 2012 was £98.8 million, a decrease of £35.4 million or 26.4% from £134.2 million for the six months ended 30 June 2011. Instalment income decreased by £7.9 million, of which £7.2 million was attributable to decreases in the Group's motor business, primarily as a result of a decrease in motor in-force policies in the first half of 2012 compared with the first half of 2011 and lower take-up rates for instalment payment options by motor customers. Other operating income decreased by £27.5 million, primarily as a result of an £18.2 million decline in expenses re-charged to run-off activities. The remaining £9.3 million decline

reflects modest declines in each of the primary categories of other income as a result of reduced earn-through from fewer in-force policies in the Group's motor insurance business.

Operating profit/(loss) from run-off activities

The table below presents results of operations for the Group's run-off activities for the six months ended 30 June 2012 and 2011.

	Six months ended 30 June	
	2012	2011
	(£ millions)	
Gross written premium	4.1	26.1
Net earned premium	9.4	296.7
Investment return	30.6	21.4
Instalment and other operating income	0.3	(11.2)
Net insurance claims	29.0	(257.5)
Total expenses	(68.1)	(61.8)
Operating profit/(loss)	**1.2**	**(12.4)**

The Group continued to wind down its run-off activities during the first half of 2012. The majority of activity related to TPF, and the income generated from that activity, is primarily passed through to Tesco in the form of commission payments. Reserve releases in the first half of 2012 resulted in positive net insurance claims of £29.0 million but also commission expenses of £66.1 million, substantially all of the total expenses from run-off activities during the first half of 2012. As a result, the Group's run-off activities generated a profit of £1.2 million during the six months ended 30 June 2012 compared with a loss of £12.4 million in the six months ended 30 June 2011.

Restructuring and other one-off costs

Restructuring and other one-off costs increased substantially during the first half of 2012 as the Group launched several of its initiatives relating to separation and divestment. Initiatives undertaken in the first half of 2012 consisted primarily of operations and systems separation from the RBS Group, assumption of certain property leases, and settlement of the debt owed to the trustee of the RBS Group Pension Fund. As a result of these and other related activities, the Group incurred restructuring and other one-off costs of £108.7 million in the six months ended 30 June 2012 compared with £9.8 million for the six months ended 30 June 2011.

Finance costs

The Group's finance costs incurred during the first half of 2012 primarily reflect interest associated with the issuance of £500 million Notes in April 2012. As a result, the Group's finance costs were £10.2 million in the six months ended 30 June 2012 compared with £1.4 million in the six months ended 30 June 2011.

Tax charge

In the first half of 2011 and 2012, the Group's statutory corporate tax rate was 26.5% and 24.5%, respectively. For the six months ended 30 June 2011, the Group's tax charge was £45.3 million, representing an effective tax rate of 24.2%. For the six months ended 30 June 2012, the Group's tax charge was £23.7 million, representing an effective tax rate of 22.3%. The actual tax charge in the first half of 2012 was lower than the Group expected principally because of a release of prior period tax provisions of £4.4 million.

Years ended 31 December 2011, 2010 and 2009

The table below presents Group's results of operations for the years ended 31 December 2011, 2010, and 2009.

	Year ended 31 December		
	2011	2010	2009
		(£ millions)	
Ongoing operations[1]			
Gross written premium	4,124.9	4,095.3	4,171.6
Net earned premium	3,890.9	3,976.8	4,029.8
Net insurance claims	(2,731.0)	(3,588.3)	(3,240.3)
Commission expenses	(394.6)	(352.9)	(300.9)
Other operating expenses	(837.6)	(851.8)	(895.8)
Underwriting result	**(72.3)**	**(816.2)**	**(407.2)**
Investment return	238.7	281.4	306.3
Instalment and other operating income	255.5	329.1	266.5
Operating profit/(loss)	**421.9**	**(205.7)**	**165.6**
Total operations			
Operating profit/(loss) from ongoing operations	421.9	(205.7)	165.6
Operating (loss) from run-off activities	(23.9)	(140.7)	(165.1)
Restructuring and other one-off costs	(54.0)	(29.0)	(80.0)
Finance costs	(2.7)	(2.7)	(4.4)
Gain recognised on disposal of subsidiary and joint venture	1.6	—	216.1
Profit/(loss) before tax	**342.9**	**(378.1)**	**132.2**
Tax (charge)/credit	(93.9)	106.2	0.9
Profit/(loss) for the year	**249.0**	**(271.9)**	**133.1**

(1) Excludes run-off activities and restructuring and other one-off costs.

Gross written premium—ongoing

Gross written premium for the Group's ongoing business remained broadly stable over the three year period but experienced mixed trends across the Group's business segments.

Since 2009, the Group reduced its exposure to higher risk policyholders, particularly young drivers in its motor business, and as a result gross written premium from the Group's motor business decreased significantly from 2009 to 2011. Decreases in the gross written premium for the Group's motor business were offset partially by increases in the Group's international business as the Group grew its motor businesses in both Italy and Germany. The Group also experienced modest gains to gross written premium in its rescue and other personal lines business throughout the period and its commercial business from 2010 to 2011.

Gross written premium for the Group's ongoing businesses for the year ended 31 December 2010 was £4,095.3 million, a decrease of £76.3 million or 1.8% from £4,171.6 million for the year ended 31 December 2009, largely reflecting a decrease in the Group's motor business of £165.0 million but partially offset by an increase in the Group's international business of £71.8 million.

Gross written premium for the Group's ongoing businesses for the year ended 31 December 2011 was £4,124.9 million, an increase of £29.6 million or 0.7% from the year ended 31 December 2010, reflecting an increase in the Group's international business of £144.5 million and increases in the Group's commercial and rescue and other personal lines businesses of £40.9 million and £14.7 million, respectively, which were largely offset by a decrease in the Group's motor business of £167.4 million.

Net earned premium—ongoing

The reduction in net earned premium for the Group's ongoing business has generally tracked changes in gross written premium from 2009 to 2011. This general trend was further affected by a decrease in reinsurance premium ceded for the Group's ongoing businesses from £169.3 million in the year ended

31 December 2009 to £142.4 million in the year ended 31 December 2010, largely as a result of decreases in premium ceded in the Group's motor business following changes to customer mix from de-risking initiatives as well as an increase in the deductible level from 2009 to 2010, reducing the reinsurance premium. The decrease in 2010 also reflects lower ceded premiums in the Group's international businesses. In 2011, the Group's Italian business agreed to cede 30% of its third-party liability book to a reinsurance partner, resulting in reinsurance premium ceded for the Group's ongoing businesses in the year ended 31 December 2011 of £251.2 million.

As a result of the trends in gross written premium and reinsurance premium ceded, net earned premium for the Group's ongoing businesses for the year ended 31 December 2010 was £3,976.8 million, a decrease of £53.0 million or 1.3% from £4,029.8 million for the year ended 31 December 2009. Net earned premium for the Group's ongoing businesses for the year ended 31 December 2011 was £3,890.9 million, a decrease of £85.9 million or 2.2% from the year ended 31 December 2010.

Net insurance claims—ongoing

Changes to the Group's net insurance claims since 2009 have been driven by changes to the Group's reserves. Net insurance claims from the Group's ongoing businesses have remained relatively stable apart from significant changes within the Group's motor business and claims related to weather in the Group's home business. Claims within the Group's motor business were impacted significantly by the increases to the Group's reserves in 2009 and 2010 in response to developments in bodily injury claims. Net insurance claims for the Group's motor business increased by £320.7 million or 16.1% from 2009 to 2010. The Group also experienced an increase in claims from adverse weather events in the first and fourth quarters of 2010, which resulted in additional claims of £149.1 million to the Group's home business in the year ended 31 December 2010. As a result, net insurance claims for the Group's ongoing businesses for the year ended 31 December 2010 were £3,588.3 million, an increase of £348.0 million or 10.7% from £3,240.3 million for the year ended 31 December 2009.

The Group did not make similar increases to its motor business reserves in 2011, and as a result net insurance claims within its motor business decreased by £861.6 million or 37.3% from 2010 to 2011. Net insurance claims within the Group's motor business also decreased because of business selection, pricing and claims improvements. Net insurance claims from the Group's ongoing businesses for the year ended 31 December 2011 were £2,731.0 million, a decrease of £857.3 million or 23.9% from the year ended 31 December 2010.

Commission expenses—ongoing

Commission expenses from the Group's ongoing operations increased steadily from 2009 to 2011, driven by an overall increase in gross written premium from distribution partnerships as well as reserving actions over that period. Reserve increases in 2009 and 2010 had the effect of reducing the profit passed to the Group's partners, resulting in lower commission expenses in those years compared to 2011. The Group's reserve releases in 2011 resulted in additional profit to the Group's partners and therefore an increase to commission expenses. As a result, commission expenses incurred under profit participations for the Group's ongoing businesses increased from £31.5 million for the year ended 31 December 2009 to £76.5 million for the year ended 31 December 2010 to £104.0 million for the year ended 31 December 2011.

The increase in commission expenses also reflects an overall increase in commissions paid to partners and PCWs by the Group's international business as a result of increases in gross written premium, which increased from £353.7 million for the year ended 31 December 2009 to £425.5 million for the year ended 31 December 2010 to £570.0 million for the year ended 31 December 2011, an overall increase of 61.2%.

As a result of these factors, commission expenses from ongoing operations for the year ended 31 December 2010 were £352.9 million, an increase of £52.0 million or 17.3% from £300.9 million in the year ended 31 December 2009. Commission expenses from ongoing operations for the year ended 31 December 2011 were £394.6 million, an increase of £41.7 million or 11.8% from the year ended 31 December 2010.

Other operating expenses—ongoing

Other operating expenses from the Group's ongoing operations decreased from 2009 to 2011, reflecting in part the Group's efforts to reduce its ongoing operating expenses through gains in operational efficiency as

part of its transformation plan, the primary components of which have been the Group's site rationalisation programme and simplified organisational structure, as well as several other one-off increases and decreases.

Other operating expenses from the Group's ongoing operations for the year ended 31 December 2010 were £851.8 million, a decrease of £44.0 million or 4.9% from £895.8 million in the year ended 31 December 2009. This decrease principally reflects a reduction in other expenses of £40.5 million due mainly to a £21.5 million decrease in the Motor Insurance Board Levy as well as a decrease in levies paid on certain creditor insurance products and a decrease in accident and repair related costs as a result of decreases in the Group's motor in-force polices. The decrease also reflects a reduction in marketing expenses of £16.0 million, which was partially offset by increases in staff costs of £13.9 million due to the migration in-house of certain functions previously provided by the RBS Group.

Other operating expenses from the Group's ongoing operations for the year ended 31 December 2011 were £837.6 million, a decrease of £14.2 million or 1.7% from the year ended 31 December 2010. The reduction was primarily a result of the Group bringing certain functions in-house which had previously been provided by the RBS Group and charged to the Group as management fees. As a result, management fees decreased by £27.4 million. This reduction was offset by an increase in the charge for the amortisation of intangible assets, following a transfer of software assets from RBS Group during 2011, and a separate charge for the impairment of certain intangible assets, and also by a £7.2 million increase in staff costs as further functions were brought in-house.

Investment return—ongoing

The table below presents a breakdown of the Group's investment return from its ongoing operations for the years ended 31 December 2011, 2010, and 2009.

	Year ended 31 December		
	2011	**2010**	**2009**
		(£ millions)	
Ongoing investment income			
Interest income on debt securities	178.0	201.2	188.2
Dividend income from equities	—	—	3.9
Other investment fund income	7.9	9.6	13.7
Cash and cash equivalent interest income	18.4	16.9	44.6
Property income	6.6	7.1	7.1
Total	**210.9**	**234.8**	**257.5**
Ongoing net realised gains			
Debt	41.8	62.3	19.5
Equity	—	—	48.4
Other	—	0.1	—
Impairments to available-for-sale financial assets	—	(21.4)	(8.3)
Net unrealised (losses)/gains from investment property	(14.0)	5.7	(10.8)
Total investment return—ongoing	**238.7**	**281.4**	**306.3**

The Group's primary ongoing investment income consists of interest earned on debt securities, which increased from £188.2 million for the year ended 31 December 2009 to £201.2 million for the year ended 31 December 2010, an increase of £13.0 million or 6.9%, as a result of increased overall investment in debt securities as part of the Group's changes to investment portfolio mix, particularly as a result of disposals of equity investments. The increased investment in debt securities resulted in higher total interest earned despite lower interest rates generally in 2010. Interest earned on debt securities decreased to £178.0 million in the year ended 31 December 2011, a decrease of £23.2 million or 11.5%, largely as a result of lower yields on debt securities reflecting generally lower interest rates in 2011, despite increased investments. Low interest rates and a rebalance of term deposits in favour of shorter maturity, and therefore lower yielding, deposits contributed to a significant decline in interest income from the Group's cash and cash equivalents, which decreased from £44.6 million in the year ended 31 December 2009 to £16.9 million in the year ended 31 December 2010, a decrease of £27.7 million or 62.1%. Interest from the Group's cash and cash equivalents remained relatively flat at £18.4 million in the year ended 31 December 2011.

Declines in interest received from debt securities and cash and cash equivalents were partially offset by increases in net realised gains on the sale of debt securities. Lower interest rates contributed to higher prices for fixed-income securities, which resulted in higher realised gains on the sale of those securities. As a result, net realised gains from the sale of debt securities increased from £19.5 million in the year ended 31 December 2009 to £62.3 million in the year ended 31 December 2010 and then declined to £41.8 million in the year ended 31 December 2011. Group investment return in the year ended 31 December 2009 was also positively impacted by a net realised gain on the sale of equity securities of £48.4 million, which resulted from the Group's decision to focus the portfolio on fixed income securities and sell its remaining equity securities. Impairments to available-for-sale financial assets in the year ended 31 December 2009 related to impairments on equity securities, and in the year ended 31 December 2010 related to corporate bonds redeemed by the RBS Group at market value that was below the issue value.

As a result of the above trends, overall investment return from ongoing operations for the year ended 31 December 2010 was £281.4 million, a decrease of £24.9 million or 8.1% from £306.3 million for the year ended 31 December 2009. The Group's investment return from ongoing operations for the year ended 31 December 2011 was £238.7 million, a decrease of £42.7 million or 15.2% from the year ended 31 December 2010.

Instalment and other operating income—ongoing

The tables below present a breakdown of the Group's instalment and other operating income from its ongoing operations for the years ended 31 December 2011, 2010, and 2009.

	Year ended 31 December		
	2011	2010	2009
	(£ millions)		
Ongoing instalment income			
Motor	100.4	107.0	121.7
Home	26.9	27.3	33.7
Other ongoing	11.2	24.7	16.3
Instalment income before RBS recharge	**138.5**	**159.0**	**171.7**
RBS recharge	—	(6.1)	(50.8)
Total instalment income—ongoing	**138.5**	**152.9**	**120.9**
Ongoing other income			
Solicitor referral fee income	27.9	39.4	31.0
Vehicle replacement referral fee income	21.9	20.0	—
Revenue from vehicle recovery and repair service	39.3	32.9	33.5
Fee income from insurance intermediary services	3.4	10.2	13.3
Other	2.6	5.0	0.8
Other operating income from third parties	**95.1**	**107.5**	**78.6**
Expenses recharged to run-off activities by ongoing segments	21.9	68.7	67.0
Total other operating income—ongoing	**117.0**	**176.2**	**145.6**
Total instalments income and other operating income—ongoing	**255.5**	**329.1**	**266.5**

Instalment income is recognised as interest income earned on the policies paid by instalments; however a portion of instalment income was historically recharged to the RBS Group. In the years ended 31 December 2009 and 2010, £50.8 million and £6.1 million of instalment income was recharged to the RBS Group based on the RBS Group's treasury allocation, which reflected the methodology at the time but which has ceased going forward. There was no recharge in the year ended 31 December 2011. Other operating income consists mainly of solicitor and vehicle replacement referral fee income, revenue from vehicle recovery and repair services, and fee income from insurance intermediary services. Other operating income also captures certain expenses incurred by the Group that were recharged to run-off activities from the Group's ongoing business segments. In the years ended 31 December 2009 and 2010, expenses recharged to run-off activities and recognised as other operating income were £67.0 million and £68.7 million, respectively. In the year ended 31 December 2011, expenses recharged to run-off activities decreased to £21.9 million. Although recorded in ongoing operations, neither the RBS Group recharge of

instalment income nor the expenses recharged to run-off activities are indicative of underlying instalment and other operating income.

Instalment and other operating income for the year ended 31 December 2010 was £329.1 million, an increase of £62.6 million or 23.4% from £266.5 million for the year ended 31 December 2009. Instalment income fell during this period by £14.7 million due to declines in instalment income within the Group's motor business as a result of the decrease in in-force policies. This decline was more than offset, however, by the reduction in the charge to the RBS Group from £50.8 million in 2009 to £6.1 million in 2010. As a result, the Group experienced an overall increase in instalment income of £32.0 million. Other operating income increased by £30.6 million, primarily as a result of an increase to solicitor referral fee income of £8.4 million and the reporting of £20.0 million of vehicle replacement referral fee income. Vehicle replacement referral fee income was previously recorded as part of net insurance claims in 2009 and not separately identified.

In the year ended 31 December 2011, instalment and other operating income was £255.5 million, a decrease of £73.6 million or 22.4% from the year ended 31 December 2010. This decrease was partially a result of a decrease in instalment income, before RBS recharge, of £20.5 million as a result of decreases in the number of in-force policies in the Group's motor business as well as from the termination of Finsure, a Group business that provided instalment payment terms to customers of the Group's commercial business. The reduction in other operating income reflects the £46.8 million decrease in expenses recharged to run-off activities. The decrease also resulted from declines in other income resulting from a reduction in fee income generated from insurance intermediary services provided by the Group's motorcycle business, which was sold during the year, and a reduction in solicitor referral fee income, though partially offset by an increase in revenue from vehicle recovery and repairs.

Operating loss from run-off activities

The table below presents the results of operations for the Group's run-off activities for the years ended 31 December 2011, 2010, and 2009.

	Year ended 31 December		
	2011	**2010**	**2009**
		(£ millions)	
Gross written premium	43.3	875.7	1,119.5
Net earned premium	362.1	996.7	1,098.5
Investment return	43.2	40.3	59.3
Instalment income and other operating income	(15.4)	(33,9)	(32.0)
Net insurance claims	(236.5)	(1,039.7)	(942.0)
Total expenses	(177.3)	(104.1)	(348.9)
Operating loss	**(23.9)**	**(140.7)**	**(165.1)**

Operating loss from run-off activities has decreased significantly as the Group exited certain businesses and put other businesses into run-off during the period from 2009 to 2011 as part of its transformation plan. Gross written premium reduced to only £43.3 million for the year ended 31 December 2011, while net earned premium remained £362.1 million as a result of premium earned off policies in run off but not yet terminated. Expenses from the Group's run-off activities increased in 2011 because of additional payments to TPF under the profit participation arrangement. As a result, operating loss from run-off activities was £140.7 million for the year ended 31 December 2010, a decrease of £24.4 million or 14.8% from £165.1 million in the year ended 31 December 2009. Operating loss from run-off activities was £23.9 million in the year ended 31 December 2011, a decrease of £116.8 million or 83.0% from the year ended 31 December 2010.

Restructuring and other one-off costs

Restructuring and other one-off costs of £80.0 million incurred in the year ended 31 December 2009 principally reflect impairments to the Group's goodwill of £66.8 million, of which £43.2 million related to Tracker Network (UK) Limited and £23.6 million to Direct Line International S.p.A. The remaining restructuring and other one-off costs for 2009 relate to the restructuring of NIG's regional distribution network, certain Group re-organisation activities and the closure of two sites, which collectively resulted in staff redundancy costs of £6.4 million and some £6.8 million of various other costs.

The restructuring and other one-off costs of £29.0 million incurred in the year ended 31 December 2010 are a result of a further impairment of goodwill of £9.3 million, staff redundancy costs of £12.3 million and £7.4 million of other costs. The staff redundancy and other costs arose principally from further activities to restructure NIG's regional distribution network, the closure of the Group's provider of finance to the Group's commercial insurance business customers and other cost reduction initiatives.

Restructuring and other one-off costs of £54.0 million incurred in the year ended 31 December 2011 reflect a further impairment of goodwill of £10.2 million relating to Tracker Network (UK) Limited and costs incurred in preparation for the separation and divestment from RBS Group. These separation costs, which comprised staff redundancy costs of £13.6 million, additional staff costs of £12.1 million to support separation and divestment activities and £18.1 million of other costs, which related to activities to consolidate the Group's underwriting entities and the introduction of the Lean programme.

Gain recognised on disposal of subsidiary and joint venture

As a consequence of a change of control at RBS Group level, the Group sold its interest in Linea Directa in 2009 and recognised a gain on disposal of subsidiary and joint venture of £216.1 million in the year ended 31 December 2009.

Tax (charge)/credit

The statutory corporate tax rate applicable to the Group during 2009 and 2010 was 28.0%.

In the year ended 31 December 2009, the Group experienced a small tax credit because the gain on the sale of Linea Directa did not give rise to a corporate tax charge due to the substantial shareholdings exemption provisions and because certain expenses and the reduction in the charge for impairment of goodwill, were not deductible for tax purposes. As a result, the tax charge was below the expected level based on the statutory rate, and the Group recorded a tax credit of £0.9 million.

In the year ended 31 December 2010, as a result of an overall loss of £378.1 million, the Group received a tax credit of £106.2 million, representing an effective tax rate of 28.1%.

In 2011, the Group's statutory corporate tax rate was 26.5%. Following a return to overall profit of £342.9 million, the Group's tax charge was £93.9 million, representing an effective tax rate of 27.4%.

Segmental analysis

The table below presents a breakdown by business segment and relative weighting within the Group's ongoing businesses of gross written premium as well as a breakdown by business segment within the Group's ongoing businesses of operating profit/(loss) for the six months ended 30 June 2012 and 2011 and the years ended 31 December 2011, 2010, and 2009.

	Six months ended 30 June				Year ended 31 December					
	2012		2011		2011		2010		2009	
	(£ millions except percentages)									
Gross written premium—ongoing										
Motor	842.1	*40.9%*	866.0	*41.4%*	1,734.8	*42.1%*	1,902.2	*46.5%*	2,067.2	*49.6%*
Home	484.4	*23.5%*	500.8	*23.9%*	1,031.3	*25.1%*	1,034.4	*25.3%*	1,030.9	*24.7%*
Rescue and other personal lines	199.3	*9.7%*	192.5	*9.2%*	350.2	*8.5%*	335.5	*8.2%*	320.9	*7.7%*
Commercial	229.8	*11.2%*	231.9	*11.1%*	438.6	*10.6%*	397.7	*9.7%*	398.9	*9.6%*
International	302.8	*14.7%*	302.0	*14.4%*	570.0	*13.8%*	425.5	*10.4%*	353.7	*8.5%*
Total	2,058.4	*100%*	2,093.2	*100%*	4,124.9	*100%*	4,095.3	*100%*	4,171.6	*100%*
Operating profit/(loss)—ongoing										
Motor	146.2		123.0		254.8		(416.9)		(132.0)	
Home	18.4		40.4		111.9		163.1		170.8	
Rescue and other personal lines	49.2		41.7		63.3		83.0		115.2	
Commercial	(1.4)		9.4		(12.4)		(40.8)		5.3	
International	11.8		(5.0)		4.3		5.9		6.3	
Total	224.2		209.5		421.9		(205.7)		165.6	

The segmental analysis below presents the individual results for each of the Group's reportable segments. In order to produce segmental results, the Group allocates a portion of central income items, such as

investment return and instalment and other income, to each segment based on their respective cost drivers. The functions responsible for this income are centrally managed, however, and therefore the operating profit/(loss) for each segment may be positively or negatively affected by actions unrelated to the underlying management of those segments. Similarly, certain of the Group's costs are incurred for central Group functions and activities and allocated to segments based on the relative contribution of net earned premium to the Group total. As a result, the Group believes loss ratio and commission ratio are good measures of underlying segmental performance. However, segmental expense ratios reflect allocations of central overhead costs, and as a result are less indicative of underlying segmental cost performance.

Motor

The table below presents results of operations for the Group's motor business for the six months ended 30 June 2012 and 2011 and the years ended 31 December 2011, 2010, and 2009.

	Six months ended 30 June		Year ended 31 December		
	2012	2011	2011	2010	2009
	(£ millions, except percentages and in-force policies)				
Gross written premium	842.1	866.0	1,734.8	1,902.2	2,067.2
Gross earned premium	840.2	916.7	1,797.4	1,932.4	2,012.2
Net earned premium	817.8	907.8	1,771.6	1,922.5	1,988.3
Net insurance claims	(592.6)	(759.2)	(1,446.8)	(2,308.4)	(1,987.7)
Commission expenses	(9.3)	(9.8)	(25.9)	(37.3)	(31.0)
Other operating expenses	(235.4)	(202.0)	(397.5)	(425.7)	(479.9)
Underwriting result	**(19.5)**	**(63.2)**	**(98.6)**	**(848.9)**	**(510.3)**
Investment return	86.4	74.6	145.2	176.3	166.6
Instalment and other operating income	79.3	111.6	208.2	255.7	211.7
Operating profit/(loss)	**146.2**	**123.0**	**254.8**	**(416.9)**	**(132.0)**
Loss ratio	72.5%	83.6%	81.7%	120.1%	100.0%
Commission ratio	1.1%	1.1%	1.5%	1.9%	1.6%
Expense ratio	28.8%	22.3%	22.4%	22.1%	24.1%
Combined operating ratio	102.4%	107.0%	105.6%	144.1%	125.7%
Current year combined operating ratio	115.7%	113.0%	113.4%	123.4%	120.9%
In-force policies	4.2	4.4	4.1	4.8	5.6

Gross written premium

Gross written premium declined slightly from the first half of 2011 compared with the first half of 2012 primarily as a result of fewer in-force policies in the first half of 2012 following the de-risking of the motor book during 2011. As a result, gross written premium from the Group's motor business was £842.1 million for the six months ended 30 June 2012, a decrease of £23.9 million or 2.8% from £866.0 million for the six months ended 30 June 2011. In-force policies remained steady at 4.1 million as at 30 June 2012 compared with 31 December 2011, and so long as it remains consistent with the Group's overall strategy, the Group expects in-force policies to remain stable within its motor business as the benefits from the transformation plan begin to emerge.

Gross written premium declined from 2009 to 2011 primarily as a result of actions taken to re-price the motor business and reduce the Group's overall exposure to higher risk policyholders. These pricing actions were taken in response to the rising cost of motor bodily injury claims and made in conjunction with significant increases to the Group's reserves during the same period. Gross written premium for the Group's motor business also declined somewhat as a result of a decrease in premiums from partners. In 2010, the Group ended its distribution relationship with Lloyds Banking Group, resulting in a loss of approximately 300,000 customers between December 2009 and December 2011. This loss was offset partially through a new distribution arrangement with Sainsbury's.

As a result of these actions, gross written premium for the Group's motor business was £1,902.2 million, a decrease of £165.0 million or 8.0% from £2,067.2 million for the year ended 31 December 2009. Gross

written premium for the Group's motor business was £1,734.8 million for the year ended 31 December 2011, a decrease of £167.4 million or 8.8% from the year ended 31 December 2010. During the same period, however, the Group reduced the number of in-force policies for its motor business from 5.6 million as at 31 December 2009 to 4.1 million as at 31 December 2011, a decrease of 26.8%. Together, the changes in gross written premiums and in-force policies led to an increase in average premium per vehicle of 15% from 2009 to 2011, even though the Group reduced its exposure to higher risk policyholders, evidencing higher average prices across the motor book.

Net earned premium

Changes in net earned premium in the first half of 2012 compared with the first half of 2011 were more significant than changes in gross written premium largely because of an increase in reinsurance premium ceded due to higher reinsurance renewal premiums following a claim made on a reinsurance policy. Net earned premium for the Group's motor business was £817.8 million for the six months ended 30 June 2012, a decrease of £90.0 million or 9.9% from £907.8 million for the six months ended 30 June 2011.

Net earned premium declined from 2009 to 2011, primarily due to the factors that affected gross written premium during the same period, while reinsurance ceded remained relatively flat. Net earned premium for the Group's motor business was £1,922.5 million for the year ended 31 December 2010, a decrease of £65.8 million or 3.3% from £1988.3 million for the year ended 31 December 2009. Net earned premium for the Group's motor business was £1,771.6 million for the year ended 31 December 2011, a decrease of £150.9 million or 7.8% from the year ended 31 December 2010.

Loss ratio

Improvement to the loss ratio in the first half of 2012 compared with the first half of 2011 was primarily due to a prior year reserve release of £108.5 million during the first half of 2012, which represented a 3.2% decrease in total Group motor reserves, compared with a prior year reserve release of £54.5 million in the first half of 2011. The reserve release in the first half of 2012 is attributable to benefits arising in large measure from the Group's claims transformation programme. As a result, the loss ratio was 72.5% for the six months ended 30 June 2012 compared with 83.6% for the six months ended 30 June 2011.

The loss ratio for the Group's motor business was impacted substantially by significant increases to the Group's prior year reserves in response to the rising cost of motor bodily injury claims. The Group's increase to prior year reserves attributable to its motor business in the year ended 31 December 2009 was £95.5 million as a response to increases in the frequency and severity of small bodily injury claims. The Group's increase to prior year reserves in the year ended 31 December 2010 was £398.1 million as a response to the rise of PPOs for large bodily injury claims. The increase in 2010 represented a 12.5% increase in total Group motor reserves, compared with an average UK market increase of 4%. As a result of these reserve increases, the loss ratio for the Group's motor business was 120.1% in the year ended 31 December 2010, an increase from 100.0% in the year ended 31 December 2009. In 2011, the Group released prior year reserves of £138.2 million as a response to de-risking actions in the Group's motor business in prior periods, the introduction of favourable regulatory reforms, and benefits from early transformation improvements in pricing and claims, and as a result the loss ratio declined substantially to 81.7% for the year ended 31 December 2011. This decrease represented a 4% decrease in total Group motor reserves, compared with an average UK market decrease of 1%.

Commission ratio

The commission ratio attributable to the Group's motor business remained unchanged at 1.1% during the first half of 2012 and the first half of 2011. The commission ratio was largely flat from 2009 to 2011, reflecting a slight reduction in partnership business as a result of the termination of the distribution partnership with Lloyds Banking Group in 2010, which resulted in lower commissions paid to partners. The commission ratio for the Group's motor business was 1.5% for the year ended 31 December 2011 compared with 1.9% for the year ended 31 December 2010 and 1.6% for the year ended 31 December 2009.

Expense ratio

The expense ratio attributable to the Group's motor business increased significantly in the first half of 2012 as a result of primarily due to an increase in total Group ongoing other operating expenses as a result of temporary increases in central overhead costs, a portion of which were allocated to the segment, as well as

declines in net earned premium. As a result, the expense ratio for the Group's motor business was 28.8% for the six months ended 30 June 2012 compared with 22.3% for the six months ended 30 June 2011.

The expense ratio attributable to the Group's motor business decreased from 2009 to 2011 as a result of a reduction in marketing costs, as well as the reduction of the Motor Insurance Bureau levy, which is a charge imposed on all motor insurance underwriters to cover uninsured drivers. The expense ratio for the Group's motor business was 22.4% for the year ended 31 December 2011 compared with 22.1% for the year ended 31 December 2010 and 24.1% for the year ended 31 December 2009.

Current year combined operating ratio

The current year combined operating ratio attributable to the Group's motor business increased marginally in the first half of 2012. The current year combined operating ratio for the Group's motor business was 115.7% for the six months ended 30 June 2012, compared with 113.0% for the six months ended 30 June 2011.

Current year combined operating ratio attributable to the Group's motor business increased somewhat from 2009 to 2010, due to the Group taking a more conservative view on large bodily injury claims. In 2011, current year combined operating income decreased as a result of improvements in pricing and risk selection in the portfolio, as well as early benefits from the claims transformation programme. The current year combined operating ratio for the Group's motor business was 113.4% in the year ended 31 December 2011 compared with 123.4% for the year ended 31 December 2010 and 120.9% for the year ended 31 December 2009.

Home

The table below presents results of operations for the Group's home business for the six months ended 30 June 2012 and 2011 and the years ended 31 December 2011, 2010, and 2009.

	Six months ended 30 June		Year ended 31 December		
	2012	2011	2011	2010	2009
	(£ millions, except for percentages and in-force policies)				
Gross written premium	484.4	500.8	1,031.3	1,034.4	1,030.9
Gross earned premium	504.3	512.2	1,031.1	1,018.7	1,009.0
Net earned premium	477.4	484.7	974.1	970.1	954.7
Net insurance claims	(303.3)	(312.5)	(559.3)	(543.3)	(519.8)
Commission expenses	(77.4)	(79.8)	(170.0)	(156.1)	(161.8)
Other operating expenses	(113.3)	(85.4)	(196.5)	(183.5)	(186.5)
Underwriting result	**(16.6)**	**7.0**	**48.3**	**87.2**	**86.6**
Investment return	22.2	17.4	28.5	39.8	51.4
Instalment and other operating income	12.8	16.0	35.1	36.1	32.8
Operating profit	**18.4**	**40.4**	**111.9**	**163.1**	**170.8**
Loss ratio	63.5%	64.5%	57.4%	56.0%	54.4%
Commission ratio	16.2%	16.5%	17.5%	16.1%	16.9%
Expense ratio	23.7%	17.6%	20.2%	18.9%	19.5%
Combined operating ratio	103.4%	98.6%	95.1%	91.0%	90.8%
Current year combined operating ratio	109.6%	87.0%	90.1%	98.1%	95.3%
In-force policies	4.3	4.4	4.3	4.3	4.3

Gross written premium

Gross written premium for the Group's home business decreased slightly in the first half of 2012 compared with the first half of 2011, reflecting fewer in-force policies in the first half of 2012. As a result, gross written premium for the Group's home business was £484.4 million for the six months ended 30 June 2012, a decrease of £16.4 million or 3.3% from £500.8 million for the six months ended 30 June 2011.

Gross written premium for the Group's home business remained largely flat from 2009 to 2011 with similarly negligible change to in-force policies, reflecting stable pricing and no significant changes to the Group's home business partners throughout the period.

Net earned premium

Net earned premium decreased marginally in the first half of 2012 compared with the first half of 2011 due to lower gross written premium for the reasons described above. As a result, net earned premium for the Group's home business was £477.4 million for the six months ended 30 June 2012, a decrease of £7.3 million or 1.5% from £484.7 million for the six months ended 30 June 2011.

Net earned premium increased marginally from 2009 to 2010, primarily due to a small decline in reinsurance premium ceded in 2010, and remained relatively flat from 2010 to 2011 with a slight increase in reinsurance ceded in 2011. Net earned premium for the Group's home business was £970.1 million for the year ended 31 December 2010, an increase of £15.4 million or 1.6% from £954.7 million for the year ended 31 December 2009. Net earned premium for the Group's home business remained relatively flat at £974.1 million for the year ended 31 December 2011.

Loss ratio

The Group's loss ratio in the first half of 2012 reflects a significant increase in weather-related claims following the wet weather in the UK from April to June, while the loss ratio in the first half of 2011 reflects increases to reserves of £55.8 million during that period as a result of late reported claims stemming from cold weather events at the end of 2010. As a result, the loss ratio for the Group's home business was 63.5% for the six months ended 30 June 2012 and 64.5% for the six months ended 30 June 2011, both of which were greater than the historical average.

Changes to the loss ratio for the Group's home business reflect the impact of unusually cold weather in 2010 as well as changes to reserves from 2009 to 2011. The loss ratio for the Group's home business was 56.0% in the year ended 31 December 2010, an increase from 54.4% in the year ended 31 December 2009. The increase was driven by additional claims of £149.1 million attributable to unusually cold weather in the first and fourth quarters of 2010 but was partly offset by a prior year reserve release of £69.0 million in 2010. The loss ratio for the year ended 31 December 2009 also benefitted from a £42.1 million prior year reserve release. The loss ratio for the Group's home business was 57.4% in the year ended 31 December 2011, an increase from the previous year, reflecting a prior year reserve increase of £48.5 million due to late claims for adverse weather in the fourth quarter of 2010, but offset by comparatively milder weather in 2011.

Commission ratio

The commission ratio remained relatively stable in the first half of 2012 compared with the first half of 2011 as a result of similar overall loss ratio affecting the profit passed through to partners.

The commission ratio attributable to the Group's home business decreased slightly from 2009 to 2010 due to the higher loss ratio in 2010, which resulted in lower profits and therefore lower commissions paid to partners. The commission ratio increased from 2010 to 2011 primarily as a result of an increase in commissions paid to PCWs due to the increasing presence of the Group's Churchill and Privilege brands on those sites and an increase in commissions paid to Nationwide under the renewed distribution partnership. The commission ratio for the Group's home business was 17.5% for the year ended 31 December 2011 compared with 16.1% for the year ended 31 December 2010 and 16.9% for the year ended 31 December 2009.

Expense ratio

The expense ratio attributable to the Group's home business increased significantly in the first half of 2012 primarily due to an increase in total Group ongoing other operating expenses as a result of temporary increases in central overhead costs, a portion of which were allocated to the segment, as well as increases in HR costs. As a result, the expense ratio for the Group's home business was 23.7% for the six months ended 30 June 2012 compared with 17.6% for the six months ended 30 June 2011.

The expense ratio attributable to the Group's home business increased slightly from 2009 to 2011. The expense ratio for the Group's home business was 20.2% for the year ended 31 December 2011 compared with 18.9% for the year ended 31 December 2010 and 19.5% for the year ended 31 December 2009.

Current year combined operating ratio

The current year combined operating ratio attributable to the Group's home business increased significantly in the first half of 2012 as a result of increased claims following wet weather in the UK from April to June. The current year combined operating ratio for the Group's home business was 109.6% for the six months ended 30 June 2012, compared with 87.0% for the six months ended 30 June 2011.

The current year combined operating ratio attributable to the Group's home business has remained relatively stable, with a small increase from 2009 to 2010 caused by adverse weather events experienced in 2010. In 2011, the current year combined operating ratio benefitted from a decrease in the loss ratio as a result of benign weather in the UK. The current year combined operating ratio for the Group's home business was 90.1% in the year ended 31 December 2011 compared with 98.1% for the year ended 31 December 2010 and 95.3% for the year ended 31 December 2009.

Rescue and Other Personal Lines

The table below presents results of operations for the Group's rescue and other personal lines business for the six months ended 30 June 2012 and 2011 and the years ended 31 December 2011, 2010, and 2009.

	Six months ended 30 June		Year ended 31 December		
	2012	2011	2011	2010	2009
	(£ millions, except for percentages and in-force policies)				
Gross written premium	199.3	192.5	350.2	335.5	320.9
Gross earned premium	201.7	202.4	410.3	413.9	436.6
Net earned premium	191.7	192.6	390.8	393.0	414.6
Net insurance claims	(90.9)	(111.6)	(173.6)	(203.2)	(251.2)
Commission expenses	(9.6)	(9.0)	(87.8)	(68.5)	(17.4)
Other operating expenses	(44.6)	(37.9)	(75.6)	(70.3)	(71.0)
Underwriting result	**46.6**	**34.1**	**53.8**	**51.0**	**75.0**
Investment return	4.2	6.7	9.5	20.2	28.0
Instalment and other operating income	(1.6)	0.9	—	11.8	12.2
Operating profit	**49.2**	**41.7**	**63.3**	**83.0**	**115.2**
Loss ratio	47.4%	58.0%	44.4%	51.7%	60.6%
Commission ratio	5.0%	4.7%	22.5%	17.4%	4.2%
Expense ratio	23.3%	19.7%	19.4%	17.9%	17.1%
Combined operating ratio	75.7%	82.4%	86.3%	87.0%	81.9%
Current year combined operating ratio	82.3%	95.1%	99.8%	96.8%	87.9%
In-force policies	9.7	9.5	9.2	9.5	8.9

Gross written premium

Gross written premium increased in the first half of 2012 compared with the first half of 2011 as a result of increases to in-force policies arising from additional travel policies tied to packaged bank accounts during the period. As a result, gross written premium for the Group's rescue and other personal lines businesses was £199.3 million for the six months ended 30 June 2012, an increase of £6.8 million or 3.5% from £192.5 million for the six months ended 30 June 2011.

Gross written premium for the Group's rescue and other personal lines businesses grew from 2009 to 2011 primarily as a result of growth in travel and pet insurance products, while the Group's rescue and recovery service remained relatively flat. In-force polices increased by 0.6 million from 31 December 2009 to 31 December 2010 as a result of competitive efforts to grow the number of travel insurance policies, particularly through the Group's distribution agreement with RBS/NatWest, however this did not result in comparable growth in gross written premium as a result of the Group's competitive pricing for those policies. In-force policies then decreased by 0.3 million by 31 December 2011 while gross written premium increased, reflecting a significant decrease in the number of policies yielding low gross written premiums per policy, such as PPI, offset by an increase in travel and pet policies, both of which generate higher gross written premiums per policy. As a result of these factors, gross written premium for the Group's rescue and

other personal lines business was £335.5 million for the year ended 31 December 2010, an increase of £14.6 million or 4.5% from £320.9 million for the year ended 31 December 2009. Gross written premium for the Group's rescue and other personal lines business was £350.2 million for the year ended 31 December 2011, an increase of £14.7 million or 4.4% from the year ended 31 December 2010.

Net earned premium

Net earned premium remained largely flat in the first half of 2012 compared with the first half of 2011.

Net earned premium decreased from 2009 to 2011 primarily as a result of the running off of the Group's PPI and creditor business throughout that period, though this was partially offset by the introduction of new income protection products in 2011. Premium from life insurance is not recognised in gross written premium, and as a result net earned premium remained higher than gross written premium despite the overall decrease during that period. Reinsurance ceded remained stable throughout the period. Net earned premium for the Group's rescue and other personal lines business was £393.0 million for the year ended 31 December 2010, a decrease of £21.6 million or 5.2% from £414.6 million for the year ended 31 December 2009. Net earned premium for the Group's rescue and other personal lines business was relatively flat at £390.8 million for the year ended 31 December 2011.

Loss ratio

The loss ratio improved significantly in the first half of 2012 compared with the first half of 2011 as a result of improved underwriting performance and favourable changes to risk mix in the rescue and other personal lines portfolio. The Group achieved this improvement despite lower reserve releases of £12.7 million in the first half of 2012 compared with £24.7 million in the first half of 2011. As a result, the loss ratio for the Group's rescue and other personal lines business was 47.4% for the six months ended 30 June 2012 compared with 58.0% for the six months ended 2011.

The loss ratio for the Group's rescue and other personal lines business was adversely affected in 2009 as a result of an assumed increase in claims against PPI products resulting from the economic downturn and potential claims for mis-selling. The loss ratio was adversely affected in 2010 by the Icelandic volcanic ash cloud and adverse winter weather events in January and December which led to an increase in travel insurance claims of £19.9 million. The loss ratio benefitted in 2010 and 2011 from prior year reserve releases of £38.5 million and £52.8 million, respectively. The 2010 release reflected a £65.3 million release for PPI products, which was partly off-set by a prior year increase for pet insurance reserves. The 2011 release arose following a lower default rate on loans than the Group had anticipated as a result of the recession in the United Kingdom. As a result, the loss ratio was 44.4% for the year ended 31 December 2011 compared with 51.7% for the year ended 31 December 2010 and 60.6% for the year ended 31 December 2009.

Commission ratio

The commission ratio for the Group's rescue and other personal lines business increased slightly to 5.0% for the six months ended 30 June 2012 compared with 4.7% for the six months ended 30 June 2011, largely as a result of increased operating profit in the first half of 2012 leading to additional commissions payable to the Group's partners.

The commission ratio for the Group's rescue and other personal lines business was well below historical levels in 2009 as a result of an anticipated increase in claims related to the Group's PPI policies and consequent reduction in profits shared with distribution partners. The commission ratio increased significantly in 2010 and 2011, primarily because of additional commission payments on PPI products under profit sharing agreements to partners, principally RBS/NatWest, which entitle the partner to receive 70-100% dependent upon the type of product. The commission ratio was also impacted by the expansion of travel insurance in-force policies through the Group's distribution agreement with RBS/NatWest. The commission ratio was 22.5% for the year ended 31 December 2011, an increase from 17.4% for the year ended 31 December 2010 and 4.7% for the year ended 31 December 2009.

Expense ratio

The expense ratio attributable to the Group's rescue and other personal lines business increased in the first half of 2012 primarily due to an increase in total Group ongoing other operating expenses as a result of temporary increases in central overhead costs, a portion of which were allocated to the segment. As a

result, the expense ratio for the Group's rescue and other personal lines business was 23.3% for the six months ended 30 June 2012 compared with 19.7% for the six months ended 30 June 2011.

The expense ratio for the Group's rescue and other personal lines business experienced a modest increase partly as a result of an increase in the marketing spend for Green Flag as well as costs related to the launch of private insurance. The expense ratio was 19.4% for the year ended 31 December 2011 compared with 17.9% for the year ended 31 December 2010 and 17.1% for the year ended 31 December 2009.

Current year combined operating ratio

The current year combined operating ratio attributable to the Group's rescue and other personal lines business decreased significantly in the first half of 2012 as a result of improved underwriting and favourable changes in business mix. The current year combined operating ratio for the Group's rescue and other personal lines business was 82.3% for the six months ended 30 June 2012, compared with 95.1% for the six months ended 30 June 2011.

The current year combined operating ratio for the Group's rescue and other personal lines business experienced increases from 2009 to 2011, primarily as a result of increases to commission ratio as a result of prior year reserve releases made in each of those years. The current year combined operating ratio was 99.8% for the year ended 31 December 2011 compared with 96.8% for the year ended 31 December 2010 and 87.9% for the year ended 31 December 2009.

Commercial

The table below presents results of operations for the Group's commercial business for the six months ended 30 June 2012 and 2011 and the years ended 31 December 2011, 2010, and 2009.

	Six months ended 30 June		Year ended 31 December		
	2012	**2011**	**2011**	**2010**	**2009**
	(£ millions, except for percentages and in-force policies)				
Gross written premium	229.8	231.9	438.6	397.7	398.9
Gross earned premium	215.2	204.9	420.5	393.1	401.1
Net earned premium	198.6	192.4	392.7	372.1	381.1
Net insurance claims	(128.8)	(113.7)	(256.7)	(261.4)	(239.2)
Commission expenses	(39.7)	(42.2)	(82.3)	(81.7)	(79.8)
Other operating expenses	(55.3)	(43.7)	(101.6)	(109.1)	(93.9)
Underwriting result	**(25.2)**	**(7.2)**	**(47.9)**	**(80.1)**	**(31.8)**
Investment return	19.0	14.4	30.5	20.4	35.4
Instalment and other operating income	4.8	2.2	5.0	18.9	1.7
Operating profit/(loss)	**(1.4)**	**9.4**	**(12.4)**	**(40.8)**	**5.3**
Loss ratio	64.9%	59.1%	65.4%	70.3%	62.8%
Commission ratio	20.0%	21.9%	21.0%	22.0%	20.9%
Expense ratio	27.8%	22.7%	25.9%	29.3%	24.6%
Combined operating ratio	112.7%	103.7%	112.3%	121.6%	108.3%
Current year combined operating ratio	142.1%	120.2%	122.0%	137.7%	122.6%
In-force policies	0.5	0.4	0.4	0.4	0.3

Gross written premium

Gross written premium for the Group's commercial business remained largely unchanged in the first half of 2012 compared with the first half of 2011.

Gross written premium for the Group's commercial business grew from 2009 to 2011 primarily as a result of growth within the segment's DL4B brand, which focused on building a direct insurance offering for micro businesses. Gross written premiums for DL4B increased from £17.0 million in the year ended 31 December 2009 to £28.4 million in the year ended 31 December 2010 to £47.8 million in the year ended 31 December 2011, representing 10.9% of commercial gross written premiums in 2011. Sales of NIG

insurance reduced marginally from £381.9 million in the year ended 31 December 2009 to £369.3 million in the year ended 31 December 2010, and subsequently increased to £390.8 million in the year ended 31 December 2011, reflecting growth in the bundled policies as well as the launch of a premium product targeted at property owners. As a result gross written premium for the Group's commercial business was £397.7 million for the year ended 31 December 2010, a decrease of £1.2 million or 2.0% from £398.9 million for the year ended 31 December 2009. Gross written premium for the Group's commercial business was £438.6 million for the year ended 31 December 2011, an increase of £40.9 million or 10.3% from the year ended 31 December 2010.

Net earned premium

Net earned premium increased slightly in the first half of 2012 compared with the first half of 2011, largely reflecting additional earn-through of premium written in prior periods, primarily in DL4B. As a result, net earned premium for the Group's commercial business was £198.6 million for the six months ended 30 June 2012, an increase of £6.2 million or 3.2% from £192.4 million for the six months ended 30 June 2011.

Net earned premium reduced slightly from 2009 to 2010 as a result of the reduction in NIG, though offset somewhat by growth in DL4B, and increased in 2011 due to the factors that affected gross written premium. Reinsurance ceded remained relatively flat. Net earned premium for the Group's commercial business was £372.1 million for the year ended 31 December 2010, a decrease of £9.0 million or 2.4% from £381.1 million for the year ended 31 December 2009. Net earned premium for the Group's commercial business was £392.7 million for the year ended 31 December 2011, an increase of £20.6 million or 5.5% from the year ended 31 December 2010.

Loss ratio

The loss ratio increased during the first half of 2012 compared with the first half of 2011 as a result of an abnormally large number of claims related to commercial property and continued conservatism in reserving for current year activity. This increase more than offset a reserve release of £58.5 million in the first half of 2012 compared with £31.7 million in the first half of 2011. As a result, the loss ratio for the Group's commercial business was 64.9% for the six months ended 30 June 2012 compared with 59.1% for the six months ended 30 June 2011.

The loss ratio for the Group's commercial business benefitted from prior year reserve releases of £54.4 million, £60.3 million and £38.4 million in each of 2009, 2010 and 2011, respectively. The loss ratio improved in 2011 as a result of improvements in bodily injury claims experience and the Group's exit from its taxi business, which historically had a high loss ratio. As a result, the loss ratio for the Group's commercial business for the year ended 31 December 2011 was 65.4%, compared with 70.3% for the year ended 31 December 2010 and 62.8% for the year ended 31 December 2009.

Commission ratio

The commission ratio for the Group's commercial business decreased slightly to 20.0% for the six months ended 30 June 2012 compared with 21.9% for the six months ended 30 June 2011, reflecting an increase in the proportion of commercial business sold direct as DL4B.

The commission ratio for the Group's commercial business from 2009 to 2011 remained relatively flat, but remains a significant component of total expenses for the commercial business due to the Group's continued focus on selling commercial insurance through brokers under the NIG brand. The commission ratio for the Group's commercial business for the year ended 31 December 2011 was 21.0% compared with 22.0% for the year ended 31 December 2010 and 20.9% for the year ended 31 December 2009.

Expense ratio

The expense ratio attributable to the Group's commercial business increased in the first half of 2012 primarily due to an increase in total Group ongoing other operating expenses as a result of temporary increases in central overhead costs, a portion of which were allocated to the segment. As a result, the expense ratio for the Group's commercial business was 27.8% for the six months ended 30 June 2012 compared with 22.7% for the six months ended 30 June 2011.

The expense ratio for the Group's commercial business grew from 2009 to 2010 as a result of a reallocation of expenses associated with Finsure, a Group business that provided instalment payment terms to customers of the Group's commercial business, from an allocation across all UK segments in 2009 to a

100% allocation to the Group's commercial business in 2010. In 2010, as a result of bad debts incurred by Finsure, it was closed, resulting in a one-time increase to expenses in the Group's commercial business of £17.3 million in 2010. Together, these actions resulted in an expense ratio of 29.3% in the year ended 31 December 2010 compared with 24.6% for the year ended 31 December 2009. Overall increases from 2009 to 2011 reflect an increase in marketing of DL4B, resulting in an expense ratio of 25.9% for the year ended 31 December 2011.

Current year combined operating ratio

The current year combined operating ratio attributable to the Group's commercial business increased significantly in the first half of 2012 as a result of property losses and continued conservatism in reserving for current year activity. The current year combined operating ratio for the Group's commercial business was 142.1% for the six months ended 30 June 2012, compared with 120.2% for the six months ended 30 June 2011.

The current year combined operating ratio for the Group's commercial business experienced a significant increase from 2009 to 2010 reflecting the impact of adverse bodily injury costs and higher one-off expenses in 2010 before returning in 2011, to levels similar to 2009. The current year combined operating ratio was 122.0% for the year ended 31 December 2011 compared with 137.7% for the year ended 31 December 2010 and 122.6% for the year ended 31 December 2009.

International

The table below presents results of operations for the Group's international business for the six months ended 30 June 2012 and 2011 and the years ended 31 December 2011, 2010, and 2009.

	Six months ended 30 June		Year ended 31 December		
	2012	**2011**	**2011**	**2010**	**2009**
	(£ millions, except for percentages and in-force policies)				
Gross written premium	302.8	302.0	570.0	425.5	353.7
Gross earned premium	260.7	222.0	482.8	361.1	340.2
Net earned premium	175.3	166.2	361.7	319.1	291.1
Net insurance claims	(137.5)	(145.9)	(294.6)	(272.0)	(242.4)
Commission expenses	(19.9)	(9.4)	(28.6)	(9.3)	(10.9)
Other operating expenses	(23.2)	(31.8)	(66.4)	(63.2)	(64.5)
Underwriting result	**(5.3)**	**(20.9)**	**(27.9)**	**(25.4)**	**(26.7)**
Investment return	13.6	12.4	25.0	24.7	24.9
Instalment and other operating income	3.5	3.5	7.2	6.6	8.1
Operating profit	**11.8**	**(5.0)**	**4.3**	**5.9**	**6.3**
Loss ratio	78.4%	87.8%	81.4%	85.2%	83.3%
Commission ratio	11.4%	5.6%	7.9%	2.9%	3.8%
Expense ratio	13.2%	19.1%	18.3%	19.8%	22.1%
Combined operating ratio	103.0%	112.5%	107.6%	107.9%	109.2%
Current year combined operating ratio	114.1%	121.2%	109.8%	121.6%	128.2%
In-force policies	1.4	1.3	1.4	1.1	0.9

Gross written premium

Gross written premium was largely unchanged in the first half of 2012 compared with the first half of 2011, reflecting overall growth in gross written premium in euro terms offset by changes to the exchange rate with pounds sterling, and stable in-force policies as the Group's international business consolidated its overall position.

Gross written premium grew significantly from 2009 to 2011 for the Group's international business as it focused on capitalising on the growing popularity of direct insurance in both Italy and Germany and increasing its market share. Total in-force policies grew from 0.9 million at 31 December 2009 to

1.4 million at 31 December 2011, an increase of 55.6%, which consisted of an increase of 0.4 million in Italy and 0.1 million in Germany. Growth of £203.3 million over that period in the Group's Italian business reflected a new distribution partnership with Fiat to provide insurance at the point of sale for new Fiat cars as well as a general increase in customer preference for purchasing car insurance through direct compared with more traditional sales agency channels. Growth of £13.0 million over that period in the Group's German business reflected a similar trend in customer preference toward purchasing direct. As a result of this growth, gross written premium for the Group's international business was £425.5 million for the year ended 31 December 2010, an increase of £71.8 million or 20.3% from £353.7 million for the year ended 31 December 2009. Gross written premium for the Group's international business was £570.0 million for the year ended 31 December 2011, an increase of £144.5 million or 34.0% from the year ended 31 December 2010.

Net earned premium

While gross written premium remained flat in the first half of 2012 compared with the first half of 2011, net earned premium grew as a result of higher gross earned premium due to earn-through effects from higher gross written premium in 2011. Net earned premium for the Group's international business for the six months ended 30 June 2012 was £175.3 million, an increase of £9.1 million or 5.5% from £166.2 million for the six months ended 30 June 2011.

Although gross written premium grew significantly from 2009 to 2011, net earned premium growth was offset by an increase in reinsurance ceded by the Group's Italian business following an agreement to cede 30% of the third-party liability book to two reinsurance partners in 2011. Reinsurance ceded was £121.1 million for the year ended 31 December 2011 compared with £42.0 million for the year ended 31 December 2010 and £49.1 million for the year ended 31 December 2009. As a result, net earned premium for the Group's international business was £319.1 million for the year ended 31 December 2010, an increase of £28.0 million or 9.6% from £291.1 million for the year ended 31 December 2009. Net earned premium for the Group's international business was £361.7 million for the year ended 31 December 2011, an increase of £42.6 million or 13.4% from the year ended 31 December 2010.

Loss ratio

Net insurance claims improved in the first half of 2012 compared with the first half of 2011 primarily because of a prior year reserve release of £19.5 million in the first half of 2012 compared with a release of £14.4 million in the first half of 2011. Coupled with the increases to net earned premium over the same period, the loss ratio for the Group's international business was 78.4% for the six months ended 30 June 2012 compared with 87.8% for the six months ended 30 June 2011.

Net insurance claims increased from 2009 to 2011 in line with overall growth in customers, and at an overall rate similar to net earned premium growth in that period. Loss ratio within the Group's Italian business remained relatively stable during that period, increasing from 78.9% in 2009 to 82.2% in 2010, largely as a result of an increase in the proportion of new business, which changed the overall risk profile of the Italian motor book. The Italian loss ratio decreased slightly to 81.2% in 2011, partially as a result of the motor book maturing somewhat as well as a positive impact from the quota share reinsurance contract in 2011. By contrast, the loss ratio in the Group's German business improved significantly from 2009 to 2011, from 95.0% in 2009 to 93.1% in 2010 to 82.0% in 2011, largely driven by the release of prior year reserves in 2011, improved underwriting and customer selection and a significant change in its quota share reinsurance arrangements. Overall, the loss ratio for the international business benefitted from prior year reserve releases of £55.5 million, £43.6 million and £7.9 million in each of 2009, 2010 and 2011, offset by current year increases to reserves of £18.0 million, £12.0 million and £12.0 million, respectively. As a result of all these factors, loss ratio for the Group's international business increased somewhat from 83.3% for the year ended 31 December 2009 to 85.2% for the year ended 31 December 2010, and then decreased to 81.4% for the year ended 31 December 2011.

Commission ratio

Increases to the commission ratio for the Group's international business in the first half of 2012 compared with the first half of 2011 are largely attributable to increased gross written premium generated through the Group's distribution partnership with Fiat. As a result, the commission ratio increased to 11.4% for the six months ended 30 June 2012 compared with 5.6% for the six months ended 30 June 2011.

Increases to the commission ratio of the Group's international business from 2009 to 2011 were primarily driven by increases to commission expenses as a result of the Group's increased distribution through partnerships and PCWs, a major proportion of which was through its partnership with Fiat in 2011. The commission ratio for the Group's international business for the year ended 31 December 2011 was 7.9% compared with 2.9% for the year ended 31 December 2010 and 3.8% for the year ended 31 December 2009.

Expense ratio

The expense ratio attributable to the Group's international business decreased significantly in the first half of 2012 as a result of a decrease in the growth of operating expenses relative to net earned premium and an increase in the amount of reinsurance premium ceded within the Group's international business. The increase in reinsurance premium ceded generated additional commissions from reinsurers, which the Group accounts for as a deduction from its operating expenses. As a result, the expense ratio for the Group's international business was 13.2% for the six months ended 30 June 2012 compared with 19.1% for the six months ended 30 June 2011.

The Group's expense ratio decreased somewhat from 2009 to 2011. While the Group's international business experienced growth in both gross written premium and in-force policies, the growth in net earned premium was lower because of premium ceded to reinsurers, which in turn affected the loss ratio. The increase in reinsurance ceded for the Group's international business had the effect of creating reinsurance commission income of £22.5 million for the Group that is netted against other operating expenses and offset general growth in overhead expenses as a result of the expansion of the Group's international business. As a result, the expense ratio for the Group's international business for the year ended 31 December 2011 was 18.3% compared with 19.8% for the year ended 31 December 2010 and 22.1% for the year ended 31 December 2009.

Current year combined operating ratio

The current year combined operating ratio attributable to the Group's international business increased in the first half of 2012 compared with the full year 2011 because the balance sheet provision for adverse reserve movement was increased in line with the Group's reserving policy, though it showed improvement compared with the first half of 2011. The current year combined operating ratio for the Group's international business was 114.1% for the six months ended 30 June 2012, compared with 121.2% for the six months ended 30 June 2011.

The current year combined operating ratio for the Group's international business decreased from 2009 to 2011 as the segment experienced benefits of greater scale. The current year combined operating ratio was 109.9% for the year ended 31 December 2011 compared with 121.6% for the year ended 31 December 2010 and 128.2% for the year ended 31 December 2009.

LIQUIDITY AND CAPITAL RESOURCES

Cash flows

The Group's primary sources of cash consist of premium receipts, investment income, proceeds from sales and redemption of investments and, in the first half of 2012, proceeds from debt financing. The Group uses cash to pay claims and claims expenses, to purchase reinsurance, to pay principal and interest on its debt obligations, to pay dividends, and for other operating expenses and taxes. Any remaining cash is invested in accordance with the Group's overall investment policy.

Historically, the Group has not consistently generated positive net cash flow from operations due to business actions taken during the historical period to exit certain unprofitable lines of business and de-risk the motor book. However, the Group's investment portfolio has often generated positive cash flow and represented a significant source of liquidity during the periods under review. As at 30 June 2012, the Group held a total of £2,481.9 million in cash and cash equivalents (net of short term borrowing), while the Group's financial investments had a total value of £7,515.8 million.

The table below presents a summary of the Group's cash flows for the six months ended 30 June 2012 and 2011 and the years ended 31 December 2011, 2010, and 2009.

	Six months ended 30 June		Year ended 31 December		
	2012	2011	2011	2010	2009
			(£ millions)		
Cash and cash equivalents at the beginning of the period/year	1,309.6	1,763.5	1,763.5	1,225.9	238.5
Net cash (used by)/generated from operating activities before investment of insurance assets	(414.3)	(165.8)	(359.8)	89.2	(178.1)
Cash generated from/(used by) insurance assets	2,239.9	(673.9)	38.8	486.0	875.7
Net cash generated from/(used by) operating activities	1,825.6	(839.7)	(321.0)	575.2	697.6
Cash flows from investing activities	(88.0)	(33.4)	(126.2)	(31.3)	316.0
Cash flows from financing activities	(553.4)	(0.2)	(0.5)	(0.9)	(0.8)
Effect of foreign exchange rate changes	(11.9)	14.3	(6.2)	(5.4)	(25.4)
Closing cash and cash equivalents at the end of the period/year	**2,481.9**	**904.5**	**1,309.6**	**1,763.5**	**1,225.9**

Net cash (used by)/generated from operating activities before investment of insurance assets

The Group's net cash from operating activities before investment of insurance assets consists primarily of profit or loss for the period, movements in working capital and tax received or paid.

Net cash from operating activities before investment of insurance assets was a cash outflow of £178.1 million in the year ended 31 December 2009 principally due to cash generated from operations of £34.2 million less tax paid of £209.4 million. Net cash from operating activities before investment of insurance assets was an inflow of £89.2 million in the year ended 31 December 2010 principally due to an inflow from cash generated from operations of £28.3 million and tax receipts of £63.4 million. Net cash from operating activities before investment of insurance assets reversed again to an outflow of £359.8 million in the year ended 31 December 2011 principally due to cash used by operations of £378.0 million, reflecting higher payments of current and prior year claims relative to declining premium income, offset by tax receipts of £20.7 million.

Net cash from operating activities before investment of insurance assets was a cash outflow of £414.3 million in the six months ended 30 June 2012 principally due to cash used by operations of £412.3 million reflecting higher payments of current and prior year claims relative to declining premium income, and significant payments related to restructuring and separation. Net cash from operating activities before investment of insurance assets was a cash outflow of £165.8 million in the six months ended 30 June 2011 due principally to cash used by operations of £164.4 million reflecting higher payments of current and prior year claims relative to declining premium income.

Cash generated from/(used by) investment of insurance assets

The Group's cash generated from/(used by) investment of insurance assets principally consists of interest received, cash generated in the form of the proceeds of disposal/maturity of the Group's investment portfolio, the purchase of available-for-sale investments and the net increase or decrease in investment balances held with credit institutions.

Net cash released from investment of insurance assets was £875.7 million in the year ended 31 December 2009, £486.0 million in the year ended 31 December 2010 and £38.8 million in the year ended 31 December 2011. The lower net increase in 2011 reflected the decision to increase the investment balances held with credit institutions by £422.9 million in that period.

Net cash released from investment of insurance assets was £2,239.9 million in the six months ended 30 June 2012 compared with £674.2 million used by investment of insurance assets in the six months ended 30 June 2011. The net cash released in the six months ended 30 June 2012 reflects a net liquidation of investments in available-for-sale financial assets and net decrease in investment balances held with credit institutions.

Cash flows from investing activities

Cash flows from investing activities consist primarily of payments and disbursements in connection with the acquisition and sale of subsidiaries, property, plant and equipment, and IT systems and software.

Cash flows from investing activities were a cash inflow of £316.0 million in the year ended 31 December 2009, reflecting the sale of Linea Directa for £330.9 million (net of cash in business at the time of sale) to Bankinter S.A, and offset by net purchases of property, plant and equipment of £6.8 million and investment in software development costs of £8.1 million. Cash flows from investing activities were a cash outflow of £31.3 million in the year ended 31 December 2010 due to net purchases of property, plant and equipment of £5.1 million and investment in software development costs of £26.2 million. Cash flows from investing activities were a cash outflow of £126.2 million in the year ended 31 December 2011 due to net purchases of property, plant and equipment of £6.3 million and investment in software development costs of £119.8 million.

The net cash outflow from investing activities for the six months ended 30 June 2012 totalled £88.0 million, comprising £48.4 million for the purchase of property, plant and equipment (six months ended 30 June 2011: £3.2 million) and £39.6 million of investment in software development costs (six months ended 30 June 2011: £30.1 million). The purchase of property, plant and equipment in the six months ended 30 June 2012 includes fixtures and fittings of £39.3 million purchased from RBS Group.

Cash flows from financing activities

Cash flows from financing activities consist primarily of dividend payments to the RBS Group, the repayment of loans to the RBS Group and the proceeds of the issue of the Notes.

During the six months ended 30 June 2012, the Group paid dividends totalling £800 million to the RBS Group, repaid loans to the RBS Group of £246.4 million and received net proceeds of £493.0 million from the issue of the Notes. All together, the net outflow from financing activities during the period amounted to £553.4 million.

Cash flows from financing activities in 2009, 2010 and 2011 were small cash outflows of £0.8 million, £0.9 million and £0.5 million respectively due to net repayment of borrowings.

Capital resources

Group solvency and financial leverage

The Group presents its solvency information on a statutory accounting basis. The Group is well capitalised with an IGD surplus of £2.2 billion and an IGD coverage ratio of 305.9% as at 30 June 2012. The Group also has a risk-based capital coverage ratio of 160.0% as at 30 June 2012. The table below sets forth the

consolidated statutory solvency capital position and IGD capital position as at 30 June 2012, and as at 31 December 2011, 2010 and 2009:

	As at 30 June 2012	As at 31 December 2011	2010	2009
	(millions, £ except ratios)			
Consolidated statutory solvency capital				
Total invested equity[1]	2,905.7	3,612.8	3,223.6	3,322.1
Goodwill and other intangible assets	(390.9)	(365.8)	(286.1)	(290.3)
Regulatory adjustments	27.0	(25.6)	(264.7)	(283.9)
Total Tier 1 capital	**2,541.8**	**3,221.4**	**2,672.8**	**2,747.9**
Upper Tier 2 capital[2]	258.5	258.5	258.5	258.5
Lower Tier 2 capital[3]	501.1	—	—	—
Regulatory adjustments	(0.7)	(37.2)	(140.1)	(4.7)
Total regulatory capital resource	**3,300.7**	**3,442.7**	**2,791.2**	**3,001.7**
European Insurance Groups Directive (IGD)				
IGD required capital[4]	1,079.0	1,079.1	1,227.3	1,049.5
IGD excess solvency	2,221.7	2,363.6	1,563.9	1,952.2
IGD coverage ratio	305.9%	319.0%	227.4%	286.0%
Risk-based capital coverage ratio	160.0%	169.5%	122.4%	159.9%

(1) Excludes £258.5 million undated loan capital reported in Tier 2 capital, which includes the TPF Note.

(2) Includes the TPF Note and £3.5 million of solvency capital provided by TPF in relation to the TPF life insurance business, both of which the Group intends, subject to the consent of the FSA, to repay, although this is not expected to happen until 2013.

(3) Includes that element of the Notes applicable for regulatory capital purposes.

(4) Based on the IGD for the Group and adjusted to include the capital requirement for Direct Line Versicherung AG.

The table below sets forth the Group's financial leverage ratio on the same basis as the Group's historical financial information as at 30 June 2012 and as at 31 December from 2011, 2010 and 2009:

	As at 30 June 2012	As at 31 December 2011	2010	2009
	(millions, £ except ratios)			
Total invested equity	2,905.7	3,612.8	3,223.6	3,322.1
Undated loan capital[1]	258.5	258.5	258.5	258.5
The Notes	516.1	—	—	—
Long term borrowings	—	247.7	249.2	250.8
Total financial debt	**774.6**	**506.2**	**507.7**	**509.3**
Total capital employed	**3,680.3**	**4,119.0**	**3,731.3**	**3,831.4**
Financial leverage ratio[2]	21.0%	12.3%	13.6%	13.3%

(1) Includes the TPF Note and £3.5 million of solvency capital provided by TPF in relation to the TPF life insurance business, both of which the Group intends, subject to the consent of the FSA, to repay, although this is not expected to happen until 2013.

(2) Total financial debt as a percentage of total capital employed.

Capital management actions

The Group's issue of Tier 2 capital in April 2012 was part of a number of capital management actions targeted at creating a more efficient capital structure ahead of the required divestment of the Group from its parent, the RBS Group.

On 10 December 2011, the Group consolidated its four UK general insurance underwriting entities by way of a FSMA Part VII transfer, enabling the Group to benefit in the future from enhanced capital fungibility, greater diversification of risk within a single underwriting entity, and operational efficiency and effectiveness. All of the Group's UK insurance business is now written through U K Insurance (although Churchill Insurance Company has a small number of legacy claims remaining in it). The Group has also

exited from relatively capital intensive low-return lines of business, including personal lines business sold via brokers, certain fleet and taxi business lines, and its motorcycle business.

In 2012, the Group paid three dividends to its parent company: the RBS Group; a £300.0 million dividend was paid on 27 March 2012, a £500.0 million interim dividend was paid on 6 June 2012 and a further dividend of £200.0 million was paid on 3 September 2012.

Subject to completion of the reserve determination process and the consent of the FSA, the Group intends to repay the TPF Note, although this is not currently expected to happen until 2013. See Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Run-off businesses—Tesco Personal Finance*".

The Group believes implementation of the above actions is consistent with its capital risk appetite.

CONTRACTUAL OBLIGATIONS

The table below presents a summary of the Group's contractual obligations as at 30 June 2012.

	Less than 1 year	1-5 years	More than 5 years	Total
		(£ millions)		
The Notes	—	—	516.1	516.1
Loans from related parties	—	—	—	—
Operating lease obligations	8.6	16.2	8.0	32.8
Total	**8.6**	**16.2**	**524.1**	**548.9**

In addition to the obligations listed above, in 2006, TPF provided the Group with the TPF Note, consisting £255 million of solvency capital which appears in the Group's Upper Tier 2 capital as a perpetual subordinated loan, and £3.5 million of solvency capital on similar terms. This £258.5 million of solvency capital is not included in the table of contractual obligations since it amounts to a perpetual loan and, therefore, does not oblige the Group to repay within a set period of time. Following the recent reserve determination, the Group confirmed to TPF its intention, subject to FSA consent, to repay the £258.5 million of undated loan capital, although this is not currently expected to happen until 2013. See Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Run-off businesses—Tesco Personal Finance*".

For further details of the Group's operating lease obligations, see "*—Off-balance sheet transactions*".

INVESTMENT ASSETS

The Group makes investments primarily to cover its technical reserves. The income from, and value of, the Group's investments have a significant impact on its financial results and capital resources position. Investment income yield (calculated as investment income as a percentage of the average financial assets) for each of the years ended 31 December 2011, 2010, and 2009 was 2.3%, 2.6% and 3.2%, respectively. The Group aims to manage its portfolio to maximise return relative to the Group's risk appetite and to serve as a stable income generator while providing a match to the Group's technical reserves and liquidity needs. For a discussion of the Group's investment strategy and controls, see Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Investments*".

As the majority of the Group's liabilities are short-tailed, fixed income investment constitutes a major part of the investment portfolio. As at 30 June 2012, 100% of the portfolio consisted of cash, gilts and other bonds. The Group currently does not hold any equity securities, however the Group is considering future changes to the nature and type of investment portfolio it holds with the aim of increased diversification and an increase in returns, through changes in the mix of asset type, duration, currency and denomination. For example, the Group is investing a portion of its fixed income credit allocation in US dollar denominated issues (hedged back into pounds sterling) and will build a commercial real estate portfolio in the UK. The Group may in the future invest in further asset classes. See Part VII: "*Information on the Company and the Group—Description of the Business of the Company and the Group—Investments—Investment strategy and controls*".

The table below presents the asset allocation of the Group's portfolio based on the currency in which the assets are held, translated into pounds sterling as at 30 June 2012, and as at 31 December 2011, 2010, and 2009:

	As at 30 June 2012	As at 31 December 2011	2010	2009
		(£ millions)		
Cash	273.1	201.9	234.3	123.5
Short term deposits[1]	2,292.5	1,177.9	1,607.1	1,136.8
Long term deposits[2]	483.0	1,489.6	963.4	1,401.3
Government bonds	2,947.1	3,481.2	3,031.5	1,686.0
Corporate bonds	3,916.4	3,843.2	3,968.6	4,607.0
Mortgage backed securities	169.3	283.5	496.1	686.3
Fixed income portfolio	10,081.4	10,477.3	10,301.0	9,640.9
UCITS[3]	—	382.8	370.9	367.3
Property	—	69.5	83.5	77.8
Total investment portfolio	**10,081.4**	**10,929.6**	**10,755.4**	**10,086.0**

(1) Short term cash deposits have a maturity of less than three months.

(2) Long term cash deposits have a maturity of more than three months.

(3) Undertakings for collective investment in transferable securities. The underlying investments consist primarily of global corporate bonds.

The fixed income portfolio consists of issuers with different credit quality. The Group assesses credit quality using the ratings published by S&P, Fitch and Moody's (all three credit rating agencies are registered in the EU). Investments in non-rated issuers are subject to specific credit limits established by the Group. Overall credit risk in the Group's fixed income portfolio is carefully managed to ensure a high quality credit portfolio. As at 30 June 2012, 50.7% of the Group's government bond and corporate bond portfolio was rated 'AAA' and 92.7% was rated 'A' or better.

The table below presents the composition of the Group's government bond and corporate bond portfolio by rating category based on carrying value as at 30 June 2012 and as at 31 December 2011, 2010, and 2009:

	As at 30 June 2012	As at 31 December 2011	2010	2009
		(£ millions)		
AAA	3,563.3	4,175.7	4,222.5	3,309.6
AA and above	726.4	770.9	1,122.9	1,732.6
A and above	2,228.2	2,255.9	1,924.9	1,771.7
BBB− and above	484.8	374.8	212.7	81.0
BB+ and below	30.1	23.3	11.9	49.3
Unrated	—	7.3	1.3	35.1
Total	**7,032.8**	**7,607.9**	**7,496.2**	**6,979.3**

The Group invests in both UK domestic as well as international corporate and sovereign bonds, and has cash holdings in certain European countries. As at 30 June 2012, the Group held £73.9 million in sovereign bonds in eurozone countries Austria, Belgium, France and the Netherlands. However, apart from cash for operations held with local banks in Italy by Direct Line Insurance S.p.A., the Group had no cash deposits with banks in Greece, Ireland, Portugal or Spain. In addition, as at 30 June 2012, the Group had £18.0 million exposure to corporate bonds in Greece, Ireland, Italy, Portugal and Spain, £33.2 million exposure to bank and other financial institutions in Greece, Ireland, Italy, Portugal and Spain, and no exposure to sovereign bonds in any of those countries.

The table below presents the geographical distribution of the Group's corporate and sovereign bond portfolios as at 30 June 2012 and 31 December 2011, 2010, and 2009:

	As at 30 June 2012	As at 31 December 2011	2010	2009
		(£ millions)		
Corporate bonds				
United Kingdom	1,129.7	1,144.2	590.1	611.7
France	234.9	249.3	133.4	27.5
Belgium	7.8	2.7	0.9	11.1
Netherlands	39.1	183.9	136.6	116.0
Germany	199.8	108.7	98.1	41.8
Italy	13.4	13.8	14.5	2.6
Ireland	4.6	13.4	119.5	120.5
Spain	—	8.7	—	—
U.S.A.	424.2	128.3	65.4	77.6
Other corporate issuers	278.3	188.3	94.7	62.2
	2,331.8	**2,041.3**	**1,253.2**	**1,071.0**
Bank and other financial institution debt securities				
United Kingdom	736.8	926.0	1,574.0	2,074.7
France	93.9	108.5	170.3	236.9
Belgium	—	4.4	4.6	13.9
Netherlands	79.9	111.1	136.4	172.0
Austria	—	10.0	9.8	9.7
Germany	239.1	275.7	254.4	287.9
Italy	—	—	9.6	60.5
Ireland	23.3	28.9	26.9	66.9
Spain	9.9	16.0	120.3	260.3
U.S.A.	137.2	185.0	299.4	384.6
Other corporate issuers	433.8	419.8	605.8	654.9
	1,753.9	**2,085.4**	**3,211.5**	**4,222.3**
Sovereign bonds				
United Kingdom	2,175.9	2,780.8	2,728.7	1,212.8
France	59.8	77.4	—	9.0
Belgium	6.9	6.9	7.0	2.8
Netherlands	4.3	4.4	4.5	4.5
Austria	2.8	2.8	2.8	—
Multilateral/supranational	500.5	488.6	253.9	364.4
Other sovereign issuers	196.9	120.3	34.5	92.4
	2,947.1	**3,481.2**	**3,031.4**	**1,685.9**
Total	**7,032.8**	**7,607.9**	**7,496.2**	**6,979.3**

The table below presents the Group's corporate bond portfolio as at 30 June 2012 and 31 December 2011, 2010, and 2009 by rating category:

	As at 30 June 2012	As at 31 December 2011	2010	2009
		(£ millions)		
AAA	145.7	96.4	62.9	648.0
AA and above	283.3	279.9	227.3	337.0
A and above	1,502.8	1,377.3	855.4	86.0
BBB− and above	400.0	287.7	107.6	—
BB+ and below	—	—	—	—
Unrated	—	—	—	—
Total	**2,331.8**	**2,041.3**	**1,253.2**	**1,071.0**

The table below presents the maturity profile for the Group's fixed income portfolio as at 30 June 2012 and 31 December 2011, 2010, and 2009:

	As at 30 June 2012	As at 31 December 2011	2010	2009
		(£ millions)		
Less than 1 year	3,798.6	3,688.2	4,650.9	3,832.0
1 to 5 years	4,707.8	4,948.3	3,893.4	3,814.4
More than 5 years	1,575.0	1,840.8	1,756.7	1,994.5
Total	**10,081.4**	**10,477.3**	**10,301.0**	**9,640.9**

The Group's total exposure to debt securities issued by members of the RBS Group, as at 30 June 2012, amounted to £233.7 million.

CLAIMS RESERVE DEVELOPMENT

The estimation of technical reserves represents an approximation of future cash flow for claims payments, and is subject to a level of uncertainty that varies depending upon the nature of the risk. Risks with a short duration have less exposure to changes that will affect future payments. Bodily injury claims are, on the other hand, very sensitive to changes in inflation, court awards, and changes to government regulations and legislation. The effects of legislation and new court awards are taken into account as soon as they are known, although in the case of the Ogden discount rate, a reduction in the rate to 1.5% has been anticipated. In cases when a judgment is not yet final and legally binding, the effect on reserves is based on a probability-weighted estimate of the possible outcomes. In 2009 and 2010, the Group significantly increased its reserves in response to developments in motor bodily injury claims, in particular a significant increase in bodily injury claims resulting in part from the rise of claims management companies, an increase in no-win/no-fee litigation, and an increase in PPOs.

Claims inflation is an underlying risk in most insurance products. The effect of claims inflation will vary depending on the characteristics of the product and the terms and conditions that apply to the settlement of claims. For nominal long-tailed reserves, an increase in the assumption regarding future claims inflation by 1% will be significant, proportional to the average duration (in number of years).

The tables below present a comparison of estimated claims costs per accident year with the previous year's estimates. The estimates are increased or decreased as losses are paid and as more information becomes known about the frequency and severity of unpaid claims. The table below represents the Group's unpaid general insurance claims reserves as at 31 December 2011 both gross and net of reinsurance.

Gross of reinsurance

	As at 31 December 2003	2004	2005	2006	2007	2008	2009	2010	2011	As at 30 June 2012	Total
						(£ millions)					
Estimate of ultimate claims costs:											
At end of accident year*	3,648.5	3,679.1	4,007.5	4,091.6	4,390.5	3,878.1	4,148.0	4,261.9	3,080.5	1,469.4	**36,655.1**
One year later*	(135.6)	(187.2)	(175.8)	(266.1)	(62.0)	23.2	120.0	(98.1)	(32.2)	—	**(813.8)**
Two years later*	(105.5)	(89.8)	(141.7)	(42.0)	(1.1)	43.9	(42.5)	(26.4)	—	—	**(405.1)**
Three years later*	(62.1)	(61.3)	(57.9)	(17.6)	49.4	(38.3)	(29.8)	—	—	—	**(217.6)**
Four years later*	(42.9)	(41.9)	(59.5)	10.1	(7.0)	(20.0)	—	—	—	—	**(161.2)**
Five years later*	(19.7)	(15.2)	15.3	(21.6)	(14.3)	—	—	—	—	—	**(55.5)**
Six years later*	(25.3)	70.5	7.8	(8.3)	—	—	—	—	—	—	**44.7**
Seven years later*	19.5	12.8	1.9	—	—	—	—	—	—	—	**34.2**
Eight years later*	7.7	14.4	—	—	—	—	—	—	—	—	**22.1**
Nine years later*	(3.0)	—	—	—	—	—	—	—	—	—	**(3.0)**
Current estimate of cumulative claims	3,281.6	3,381.4	3,597.6	3,746.1	4,355.5	3,886.9	4,195.7	4,137.4	3,048.3	1,469.4	**35,099.9**
Cumulative payments to date	(3,153.3)	(3,166.7)	(3,421.7)	(3,466.9)	(3,918.3)	(3,353.2)	(3,232.6)	(3,034.7)	(1,809.2)	(404.1)	**(29,051.7)**
Liability recognised in balance sheet	128.3	214.7	175.9	279.2	437.2	533.7	872.1	1,102.7	1,239.1	1,065.3	**6,048.2**
Liability in respect of prior years before 2002											**204.5**
Loss adjustment expenses											**147.9**
Total gross liability included in balance sheet											**6,400.6**

* The movement in the leading diagonal for each accident year relates to the six month period ended 30 June 2012.

Net of reinsurance

	As at 31 December									As at 30 June	
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total
	(£ millions)										
Estimate of ultimate claims costs:											
At end of accident year*	3,207.4	3,486.1	3,869.6	4,030.8	4,341.3	3,816.0	4,113.0	4,219.3	2,946.1	1,352.8	**35,382.4**
One year later*	(103.3)	(169.2)	(159.3)	(249.7)	(81.7)	24.1	70.0	(109.7)	(62.6)	—	**(841.4)**
Two years later*	(101.8)	(94.1)	(159.4)	(52.7)	(23.3)	8.2	(23.0)	(57.9)	—	—	**(504.0)**
Three years later*	(71.0)	(68.3)	(62.0)	(28.2)	17.7	(24.5)	(46.1)	—	—	—	**(282.4)**
Four years later*	(42.4)	(53.3)	(61.6)	9.9	(10.4)	(33.2)	—	—	—	—	**(191.0)**
Five years later*	(36.0)	(13.5)	7.2	(43.5)	(20.6)	—	—	—	—	—	**(106.4)**
Six years later*	(20.5)	60.7	(0.4)	(18.8)	—	—	—	—	—	—	**21.0**
Seven years later*	5.5	(4.1)	(5.4)	—	—	—	—	—	—	—	**(4.0)**
Eight years later*	6.2	(9.2)	—	—	—	—	—	—	—	—	**(3.0)**
Nine years later*	(9.1)	—	—	—	—	—	—	—	—	—	**(9.1)**
Current estimate of cumulative claims	2,835.0	3,135.1	3,428.7	3,647.8	4,223.0	3,790.6	4,113.9	4,051.7	2,883.5	1,352.8	**33,462.1**
Cumulative payments to date	(2,775.3)	(3,010.8)	(3,295.3)	(3,416.2)	(3,857.9)	(3,324.8)	(3,293.6)	(3,018.4)	(1,738.9)	(385.2)	**(28,116.4)**
Liability recognised in balance sheet	59.7	124.3	133.4	231.6	365.1	465.8	820.3	1,033.3	1,144.6	967.6	**5,345.7**
Liability in respect of prior years before 2002											**96.1**
Loss adjustment expenses											**147.9**
Total net liability											**5,589.7**

* The movement in the leading diagonal for each accident year relates to the six month period ended 30 June 2012.

OFF-BALANCE SHEET TRANSACTIONS

The Group did not have any off-balance sheet transactions during the six months ended 30 June 2012 or during the years ended 31 December 2011, 2010 and 2009, except for its operating lease commitments, which are described below.

The total remaining rentals payable under non-cancellable operating leases are as follows:

	As at 30 June 2012	As at 31 December 2011	2010	2009
	(£ millions)			
Less than one year	8.6	8.7	9.2	9.8
1 - 5 years	16.2	19.0	18.7	21.3
More than 5 years	8.0	9.3	10.6	12.1
Total	**32.8**	**37.0**	**38.5**	**43.2**

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Group believes the primary components of market risk affecting its business are interest rate risk, credit risk, including with respect to fixed income investments and the Group's reinsurers, currency risk, and property price risk. For more information on market risk, see Note 3.7.1 to the Group's historical financial information included in Part XIII: "*Financial Information*" of this prospectus.

Interest rate risk

The substantial majority of the Group's investment portfolio consists of fixed income securities, and as a result the portfolio is subject to interest rate risk. Interest rate risk arises from the asset liability mismatch exposure to the fluctuation of the interest rate. On the asset side, the interest rate risk exposure arises from the Group's investment in fixed income securities. On the liabilities side, the Group's exposure arises from PPOs and subordinated liabilities.

As at 30 June 2012, £401.4 million of the Group's UK investment portfolio is invested in US dollar-denominated corporate bonds, which the Group acquired in May 2012. When interest rates rise, the market value of the Group's bond holdings falls. This is not offset by a fall in fixed interest rate liabilities. To hedge the interest rate exposure on the US dollar portfolio, the Group uses a series of 'fixed into floating' interest rate swaps, which change value in response to the rate changes in a direction opposite to bonds thereby providing a hedge.

Credit risk

Credit risk arises from the potential that losses are incurred from the failure of a counterparty to meet its credit obligations, either due to its failure and/or its inability to pay, or its unwillingness to pay amounts due.

The Group is primarily exposed to credit risk through the fixed income investments in its investment portfolio, but is also exposed to counterparty risk with its reinsurers. For investments, the Group sets credit risk limits, the basis of which are primarily credit ratings from a recognised rating agency, including S&P, Fitch or Moody's. For unrated issuers, a credit analysis is made in order to set the credit limit. The approved limits are applied to all separate investments and include exposure through derivatives.

Currency risk

The UK portfolio had exposure to foreign currency (US dollar and euros) as a result of an investment in a managed fund which was hedged back to pounds sterling. The value of this holding as at 30 June 2012 was £nil, compared with £382.8 million, £370.9 million and £367.3 million as at 31 December 2011, 2010 and 2009, respectively.

The proportion of the UK portfolio that the Group invested in US dollar-denominated corporate bonds is hedged back to pounds sterling using a series of forward foreign exchange contracts. The value of this holding as at 30 June 2012 was £401.4 million, compared with £nil as at 31 December 2011, 2010 and 2009.

Other foreign currency exposure such as outsourced supply services, international motor insurance cover or travel insurance cover policies have a lower level of materiality. The majority of the insurance business is underwritten in local currency, in pounds sterling for the UK subsidiaries and in euros for the German and Italian subsidiaries.

For claims and premium reserves, the Group has very little foreign exchange risk as the majority of claims are denominated in the domiciled currency of operation of the relevant Group company, except for some foreign travel risks in the Group's motor and travel policies.

With the exception of the Group's US dollar-denominated corporate bonds acquired in May 2012 and assets related to the Group's international businesses in Germany and Italy, predominantly all the Group's financial assets and liabilities are denominated in pounds sterling and do not bear any exposure to currency risk.

As at June 2012, £1.4 million in cash has been pledged by the Group as collateral with regards to facilitating derivative trading (both interest rate and foreign exchange). The Group believes the terms and conditions of collateral pledged for both assets and liabilities are market standard.

Property price risk

The Group is exposed to property price risk from properties that form part of its own premises. As at 30 June 2012, all the properties are held in the UK and are subject to the asset admissibility rules of the FSA. Under the new investment strategy, the main UK subsidiary is reallocating a maximum of 5% of its portfolio into real estate over a period of around eighteen months, which commenced in August 2012. The risk exposure of these investments will be monitored through the value at risk measure.

Sensitivity analysis

The following table presents the sensitivity profit/(loss) before tax (net of reinsurance) to different external market events, as at 30 June 2012 and as at 31 December 2011, 2010, and 2009. For more information on sensitivity analysis conducted on the Group's investment assets, see Note 3.7.1 to the Group's historical financial information included in Part XIII: "*Financial Information*" of this prospectus.

	As at 30 June 2012	As at 31 December		
		2011	2010	2009
	(£ millions)			
1% increase/(decrease) in interest rates	7.9 / (7.9)	9.2 / (9.2)	12.7 / (13.0)	22.4 / (22.9)
15% increase/(decrease) in other investment funds and property market values	—	10.4 / (10.4)	12.5 / (12.5)	11.7 / (11.7)

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of the financial information contained in this prospectus requires the Board to make estimates and assumptions that affect the reported amounts of assets and liabilities as well as the disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses during the reporting period. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual outcomes could differ from those estimates.

The Board has identified the following accounting estimates and judgements as being critical to understanding Group's financial position, as they require the Board to make complex and/or subjective judgements and estimates about matters that are inherently uncertain.

General insurance: outstanding claims provisions and related reinsurance recoveries

The Group makes provision for the full cost of outstanding claims from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and loss adjustment expenses. Outstanding claims provisions net of related reinsurance recoveries as at 30 June 2012 amounted to £5,589.7 million, compared with £5,807.7 million, £6,311.0 million and £5,434.1 million as at 31 December 2011, 2010 and 2009, respectively.

The traditional method of settling a bodily injury claim is via an "Ogden lump sum", calculated based on the estimated future earnings of the claimant and the annual cost of medical care required over the expected future time to retirement age/lifetime. Other estimates are also required for case management expenses, loss of pension, court protection fees, alternations to accommodation and transportation fees. The estimated future costs are discounted back to the settlement date using the Ogden discount rate, which is currently 2.5%.

The Lord Chancellor has announced a review of the approach to setting the Ogden discount rate in light of the current economic climate and claim environment. Any reduction in the discount rate would significantly increase the cost of claims settled via an Ogden lump sum.

From 2010, the Group has calculated its estimated reserve based on an assumed discount rate of 1.5%. In 2009, the Group calculated its estimated reserve based on an assumed discount rate of 2.5%. This reserving assumption excludes PPOs, for which separate reserves are established. The interaction of the relative costs of PPOs and Ogden amounts have been allowed for in the calculation of the Ogden discount rate adopted.

Outstanding claims provisions are not discounted for the time value of money except for those in respect of PPOs under the Courts Act 2003. Total discounted reserves for claims that have already been settled by way of a PPO, gross of reinsurance, were £266.2 million as at 30 June 2012, compared with £203.9 million, £185.9 million and £91.6 million as at 31 December 2011, 2010 and 2009, respectively, and net of reinsurance were £108.1 million as at 30 June 2012, compared with £80.3 million, £54.3 million and £26.1 million as at 31 December 2011, 2010 and 2009, respectively. The corresponding undiscounted amounts, gross of reinsurance, were £944.6 million as at 30 June 2012 compared with £730.4 million, £646.3 million and £275.7 million as at 31 December 2011, 2010 and 2009, respectively, and net of reinsurance were £354.9 million as at 30 June 2012 compared with £245.1 million, £195.2 million and £61.8 million as at 31 December 2011, 2010 and 2009, respectively. Total discounted claims reserves estimated to be settled by PPOs in respect of both claims reported prior to the period end and incurred but not reported claims, gross of reinsurance, were £1,268.1 million as at 30 June 2012 compared with £1,166.5 million and £1,180.0 million as at 31 December 2011 and 2010, respectively, and net of reinsurance were £855.9 million as at 30 June 2012 compared with £835.3 million and £826.6 million as at 31 December 2011 and 2010 respectively. The corresponding undiscounted amounts, gross of reinsurance, were £4,218.8 million as at 31 June 2012 compared with £3,856.9 million and £4,320.9 million as at 31 December 2011 and 2010, respectively, and net of reinsurance were £2,448.4 million as at 30 June 2012 compared with £2,404.9 million and £2,659.6 million as at 31 December 2011 and 2010 respectively.

The amounts for 2012, 2011 and 2010 include a provision for estimated PPOs incurred but not reported which was not provided in 2009.

The value of claims with a periodical payment are calculated via a cash flow model. PPO claims are projected using the terms of the settlement, the assumed life expectancy, and adjusted for the inflation agreed in the settlement. Outstanding lump sums are estimated using the claims handlers' case estimates, for both the claim with the PPO and any other claims arising from the same accident. The average interval

between the date of the last future cash flow being discounted and the end of the financial year was 50 years as at 30 June 2012 and 31 December 2011 and 2010 compared with 40 years as at 31 December 2009. This is calculated for each of the claims settled by PPO as the mean of the Group's and the claimant's expert medical advice on the claimant's life expectancy. Reinsurance is calculated on the accident's entire costs, and the net cash flows are discounted for the time value of money to allow for investment earnings.

In the majority of cases the inflation index agreed in the settlement is the Annual Survey of Hours and Earnings inflation, for which the long-term rate is assumed to be 4.5%. The rate of interest used for the calculation of present values was also 4.5% as at 30 June 2012, compared with 4.5%, 4.5% and 4.14% as at 31 December 2011, 2010 and 2009, respectively, which, in the case of 4.5%, results in a real discount rate of 0.0%. All future payments in respect of settled PPOs are discounted to the current valuation date. All future payments in respect of incurred but not reported PPO claims are discounted to the assumed settlement date of each claim, rather than the current valuation date.

Details of sensitivity analysis to the discount rate applied to PPO claims are shown in note 3.7.1 to the Group's historical financial information included in Part XIII: "*Financial Information*".

Impairment provisions—available-for-sale assets

The Group determines that available-for-sale financial assets are impaired when there has been a significant or prolonged decline in the fair value below its cost or if there is objective evidence that an event or events since initial recognition of the assets have adversely affected the amount or timing of future cash flows from the asset. The determination of what is significant or prolonged requires judgement. In making this judgement, the Group evaluates among other factors, the normal volatility of share price, the financial health of the investee, industry and sector performance, changes in technology and operational and financing cash flow. Impairment may be appropriate when there is evidence of deterioration in these factors.

On a quarterly basis, the Group reviews whether there is any objective evidence that the direct investments in debt securities are impaired based on the following criteria:

- price performance of a particular debt security, or group of debt securities, demonstrating an adverse trend compared to the market as a whole;
- adverse movements in the credit rating for corporate debt; and
- actual, or imminent, default on coupon interest or nominal.

Impairment provision charges on debt securities available-for-sale financial assets was £nil as at 30 June 2012, compared with £2.0 million, £21.4 million and £nil as at 31 December 2011, 2010 and 2009, respectively.

Had all the declines in available-for-sale asset values met the criteria above, the Group would have suffered a further £37.3 million loss in the six months ended 30 June 2012, compared with a £37.6 million loss for the six months ended 30 June 2011 and losses of £37.3 million, £58.2 million and £102.3 million during the years ended 31 December 2011, 2010 and 2009, respectively, being the transfer of the total available-for-sale reserve for unrealised losses to the income statement. These movements represent mark to market movements and where there is no objective evidence of any loss events that could effect future cash flows, no impairments are recorded for these movements.

Fair value

Financial assets classified as available-for-sale are recognised in the financial information at fair value. In the balance sheet, financial assets carried at fair value are included within available-for-sale debt securities and equity shares. Unrealised gains and losses on available-for-sale financial assets are recognised directly in other comprehensive income unless an impairment loss is recognised.

The fair value of all available-for-sale financial assets was determined using observable market input and amounted to £7,032.8 million as at 30 June 2012, compared with £7,990.7 million, £7,867.1 million and £7,346.6 million as at 31 December 2011, 2010 and 2009, respectively. The judgements and assumptions adopted by management in the valuation of available for sale financial assets when a market is not active, require the use of valuation techniques. These valuation techniques involve a degree of estimation and are

noted in Note 1.12 to the Group's historical financial information. Details on sensitivity analysis are shown in Note 3.7.1 to the Group's historical financial information included in Part XIII: "*Financial Information*".

Deferred acquisition costs

The Group defers a proportion of acquisition costs incurred during the year to subsequent accounting periods. Management uses estimation techniques to determine the level of costs to be deferred, by category of business. Judgement is used to determine the types of cost that can be deferred and these are referred to in Note 1.7 to the Group's historical financial information included in Part XIII: "*Financial Information*". The total deferred acquisition costs were £337.1 million as at 30 June 2012, compared with £310.5 million, £299.5 million and £338.5 million as at 31 December 2011, 2010 and 2009, respectively. During the first half of 2012, management reviewed the costs included in the calculation of deferred acquisition costs and considered them to be appropriate, and have estimated that they are recoverable.

Goodwill

The Group capitalises goodwill arising on the acquisition of businesses as discussed in Note 1.8 to the Group's historical financial information included in Part XIII: "*Financial Information*". The carrying value of goodwill was £211.0 million as at 30 June 2012, compared with £211.0 million, £221.2 million and £230.5 million as at 31 December 2011, 2010 and 2009, respectively.

Goodwill is the excess of the cost of an acquired business over the fair value of its net assets. The determination of the fair value of assets and liabilities of businesses acquired requires the exercise of management judgement; for example those financial assets and liabilities for which there are no quoted prices, and those non-financial assets where valuations reflect estimates of market conditions, such as property. Different fair values would result in changes to the goodwill arising and to the post-acquisition performance of the acquisition. Goodwill is not amortised but is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units or groups of cash-generating units expected to benefit from the combination. Goodwill impairment testing involves the comparison of the carrying value of a cash-generating unit or group of cash-generating units with its recoverable amount. The recoverable amount is the higher of the unit's fair value and its value in use. Value in use is the present value of expected future cash flows from the cash-generating unit or group of cash-generating units. Fair value is the amount obtainable for the sale of the cash-generating unit in an arm's length transaction between knowledgeable, willing parties.

Impairment testing inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of cash-generating units; and the valuation of the separable assets of each business whose goodwill is being reviewed.

Accountant's report

Deloitte.

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28 September 2012

Dear Sirs

Direct Line Insurance Group plc

We report on the financial information for the three years and six months ended 30 June 2012 set out on pages 176 to 279 of the prospectus dated 28 September 2012 of Direct Line Insurance Group plc (the "**Company**" and, together with its subsidiaries, the "**Group**") (the "**Prospectus**"). This financial information has been prepared for inclusion in the Prospectus on the basis of the accounting policies set out in Note 1 to the financial information. This report is required by Annex I item 20.1 of Commission Regulation (EC) No 809/2004 (the "**Prospectus Directive Regulation**") and is given for the purpose of complying with that requirement and for no other purpose.

We have not audited or reviewed the financial information for the period ended 30 June 2011 which has been included for comparative purposes only, and accordingly do not express an opinion thereon.

Responsibilities

As described in paragraph 9, the Directors of the Company are responsible for preparing the financial information on the basis of preparation set out in Note 1 to the financial information.

It is our responsibility to form an opinion on the financial information and to report our opinion to you.

Save for any responsibility arising under Prospectus Rule 5.5.3R(2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in accordance with this report or our statement, required by and given solely for the purposes of complying with Annex I item 23.1 of the Prospectus Directive Regulation, consenting to its inclusion in the Prospectus.

Basis of opinion

We conducted our work in accordance with Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of significant estimates and judgments made by those responsible for the preparation of the financial information and whether the accounting policies are appropriate to the entity's circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in jurisdictions outside the United Kingdom, including the United States of America, and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

Opinion on financial information

In our opinion, the financial information gives, for the purposes of the Prospectus, a true and fair view of the state of affairs of the Group as at 30 June 2012, 31 December 2011, 2010 and 2009 and of its profits, cash flows and changes in equity for the three years and six months ended 30 June 2012 in accordance with the basis of preparation set out in Note 1 to the financial information.

Declaration

For the purposes of Prospectus Rule 5.5.3R(2)(f), we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with Annex I item 1.2 of the Prospectus Directive Regulation.

Yours faithfully

Deloitte LLP
Chartered Accountants

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Deloitte LLP is the United Kingdom member firm of Deloitte Touche Tohmatsu Limited ("DTTL"), a UK private company limited by guarantee, whose member firms are legally separate and independent entities. Please see www.deloitte.co.uk/about for a detailed description of the legal structure of DTTL and its member firms.

Member of Deloitte Touche Tohmatsu Limited

BASIS OF PREPARATION OF THE HISTORICAL FINANCIAL INFORMATION

The combined financial information presented has been prepared for the combined group which comprises the Company and its subsidiaries (together the "**Group**"). The combined financial information has been prepared on a historical cost basis except for investment properties and those financial instruments that have been measured at fair value.

The combined financial information has been prepared in accordance with the requirements of the Prospectus Directive regulation and the Listing Rules in accordance with this basis of preparation. The basis of preparation describes how the financial information has been prepared in accordance with IFRS as adopted by the European Union ("**EU**") except as described below.

IFRS as adopted by the EU does not provide for the preparation of combined financial information and accordingly, in preparing the combined financial information, certain accounting conventions commonly used in the preparation of historical financial information for the inclusion in investment circulars as described in the Annexure to SIR 2000 (Investment Reporting Standards applicable to public reporting engagements on historical financial information) issued by the UK Auditing Practices Board have been applied. The application of these conventions results in the following material departure from IFRS as adopted by the EU:

- The Group has incurred certain costs in respect of services provided to the Group by RBS Group that were incurred but not invoiced by RBS Group. The Conceptual Framework for Financial Reporting, paragraph 4.49, gives guidance that expenses should be recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen. As there is no contractual liability to pay and therefore no liability has arisen in connection with these costs, the costs would not be recorded in the combined financial information of the Group under IFRS.
- The combined financial information includes these costs in order to present the cost base of the Group during the period covered by the combined financial information. As these cost allocations did not result in a corresponding cash payment, they are offset by an entry in equity, described as 'demerger reserves', and are reflected in the notes to the cash flow statements (Note 35) within 'non cash movement in demerger reserve'.

In all other respects, IFRS as adopted by the EU has been applied.

The Group was formed on 2 April 2012 when the Company acquired Direct Line Versicherung AG. Prior to this date, the Group was not held by a single legal entity and accordingly, consolidated financial statements do not exist. The combined financial information has been prepared using merger accounting principles, as if the transaction that gave rise to the formation of the Group had taken place at the beginning of the comparative period. Under these principles, the combined financial information has been prepared as if the Company were the holding company of Direct Line Versicherung AG, from 1 January 2009, the date of the beginning of the comparative period. The assets, liabilities and the profit or loss of the Company and its subsidiaries, and of Direct Line Versicherung AG have been combined. All transactions and balances between the entities included within the Group have been eliminated. The combined financial information reflects a liability payable to RBS Group at each period end prior to acquisition for the Direct Line Versicherung AG consideration. As the basis of preparation represents a reorganisation of entities under common control, it is therefore outside the scope of IFRS 3, Business Combinations. Accordingly, as permitted by IAS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors', it has been accounted for as a group reorganisation.

Adoption of new and revised standards

There have been no new or revised standards adopted in the period.

DIRECT LINE INSURANCE GROUP PLC

HISTORICAL FINANCIAL INFORMATION

FOR THE SIX MONTHS ENDED 30 JUNE 2012 AND 2011, AND THE YEARS ENDED 31 DECEMBER 2011, 2010 AND 2009

DIRECT LINE INSURANCE GROUP PLC
COMBINED INCOME STATEMENT

	Notes	Six months ended 30 June 2012 £ Million	Six months ended 30 June 2011 £ Million (unaudited)	Year ended 31 December 2011 £ Million	Year ended 31 December 2010 £ Million	Year ended 31 December 2009 £ Million
Gross earned premium	5	2,034.7	2,367.9	4,522.9	5,152.4	5,330.4
Reinsurance premium ceded	5	(164.5)	(127.5)	(269.9)	(178.9)	(202.1)
Net earned premium		**1,870.2**	**2,240.4**	**4,253.0**	**4,973.5**	**5,128.3**
Investment return	6	176.0	146.9	281.9	321.7	365.6
Instalment income	7	62.1	76.7	145.0	187.7	155.9
Other operating income	7	37.0	46.3	95.1	107.5	78.6
Total income		**2,145.3**	**2,510.3**	**4,775.0**	**5,590.4**	**5,728.4**
Insurance claims	8	(1,509.1)	(1,769.1)	(3,160.6)	(4,884.7)	(4,301.7)
Insurance claims recoverable from reinsurers	8	285.0	68.7	193.1	256.7	119.4
Net insurance claims		**(1,224.1)**	**(1,700.4)**	**(2,967.5)**	**(4,628.0)**	**(4,182.3)**
Commission expenses	9	(222.0)	(184.3)	(518.9)	(378.7)	(560.8)
Other operating expenses	10	(582.5)	(438.3)	(944.6)	(959.1)	(1,064.8)
Total expenses		**(804.5)**	**(622.6)**	**(1,463.5)**	**(1,337.8)**	**(1,625.6)**
Operating profit / (loss)		**116.7**	**187.3**	**344.0**	**(375.4)**	**(79.5)**
Finance costs	11	(10.2)	(1.4)	(2.7)	(2.7)	(4.4)
Gain on disposal of subsidiary and joint venture	19	—	1.6	1.6	—	216.1
Profit / (loss) before tax		**106.5**	**187.5**	**342.9**	**(378.1)**	**132.2**
Tax (charge) / credit	12	(23.7)	(45.3)	(93.9)	106.2	0.9
Profit / (loss) for the period		**82.8**	**142.2**	**249.0**	**(271.9)**	**133.1**
Profit / (loss) attributable to:						
Owners of the Company		82.8	142.2	249.0	(271.9)	133.1
Non-controlling interests		—	—	—	—	—
		82.8	**142.2**	**249.0**	**(271.9)**	**133.1**
Earnings / (loss) per share —basic and diluted (pence)	15	5.5	9.5	16.6	(18.1)	8.9

DIRECT LINE INSURANCE GROUP PLC
COMBINED STATEMENT OF COMPREHENSIVE INCOME

		Six months ended 30 June		Year ended 31 December		
	Notes	2012 £ Million	2011 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
			(unaudited)			
Profit / (loss) for the period		**82.8**	**142.2**	**249.0**	**(271.9)**	**133.1**
Other comprehensive (loss) / income						
Actuarial (loss) / gain on defined benefit plan	33	(3.0)	—	(0.6)	10.9	(8.6)
Exchange differences on translation of foreign operations		(1.5)	6.0	(3.5)	(2.8)	(19.6)
Fair value gain on available-for-sale investments	28	62.5	71.4	183.8	133.6	247.9
Less: realised net gains on available-for-sale investments	28	(64.7)	(21.4)	(52.3)	(46.8)	(62.1)
		(6.7)	56.0	127.4	94.9	157.6
Tax credit / (charge) on other comprehensive income		0.8	(12.8)	(36.8)	(27.4)	(41.5)
Other comprehensive (loss) / income for the period		**(5.9)**	**43.2**	**90.6**	**67.5**	**116.1**
Total comprehensive income / (loss) for the period		**76.9**	**185.4**	**339.6**	**(204.4)**	**249.2**
Total comprehensive income / (loss) attributable to:						
Owners of the Company		76.9	185.4	339.6	(204.4)	249.2
Non-controlling interests		—	—	—	—	—
		76.9	**185.4**	**339.6**	**(204.4)**	**249.2**

DIRECT LINE INSURANCE GROUP PLC
COMBINED BALANCE SHEET

	Notes	As at 30 June 2012 £ Million	As at 31 December 2011 £ Million	2010 £ Million	2009 £ Million
ASSETS					
Goodwill and other intangible assets	16	390.9	365.8	286.1	290.3
Property, plant and equipment	17	85.3	46.9	52.6	59.2
Investment property	18	—	69.5	83.5	77.8
Reinsurance assets	20	964.2	741.6	660.9	517.6
Deferred tax assets	13	31.0	26.9	17.0	17.1
Current tax assets	12	4.4	—	25.9	50.8
Deferred acquisition costs	21	337.1	310.5	299.5	338.5
Insurance and other receivables	22	1,233.8	1,252.9	1,606.2	1,732.8
Prepayments, accrued income and other assets		61.6	92.2	113.3	92.2
Derivative financial instruments	23	17.1	0.1	—	1.3
Retirement benefit asset	33	2.5	2.6	—	—
Financial investments	24	7,515.8	9,480.3	8,830.5	8,747.9
Cash and cash equivalents	25	2,565.6	1,379.8	1,841.4	1,260.3
Assets held-for-sale	26	1.0	1.0	—	—
Total assets		**13,210.3**	**13,770.1**	**13,816.9**	**13,185.8**
EQUITY					
Invested capital	27	1,500.0	1,500.0	1,500.0	1,500.0
Other reserves	28	613.6	575.2	590.4	411.4
Retained earnings	28	792.1	1,537.6	1,133.2	1,410.7
Total invested equity		2,905.7	3,612.8	3,223.6	3,322.1
Non-controlling interest	28	258.5	258.5	258.5	258.5
Total equity		**3,164.2**	**3,871.3**	**3,482.1**	**3,580.6**
LIABILITIES					
Subordinated liabilities	29	516.1	—	—	—
Insurance liabilities	30, 31	6,514.6	6,509.0	6,941.4	5,928.5
Unearned premium reserve	30	1,946.7	1,931.6	2,288.6	2,499.8
Borrowings	32	83.7	317.9	327.1	285.2
Derivative financial instruments	23	1.6	—	0.7	—
Retirement benefit obligations	33	—	—	0.1	13.6
Trade and other payables including insurance payables	34	737.2	910.2	698.0	801.0
Deferred tax liabilities	13	15.1	12.1	76.3	76.8
Current tax liabilities	12	231.1	218.0	2.6	0.3
Total liabilities		**10,046.1**	**9,898.8**	**10,334.8**	**9,605.2**
Total equity and liabilities		**13,210.3**	**13,770.1**	**13,816.9**	**13,185.8**

DIRECT LINE INSURANCE GROUP PLC

COMBINED STATEMENT OF CHANGES IN EQUITY

For each of the years ended 31 December 2011, 2010, 2009 and the six months ended 30 June 2012

	Note	Invested capital £ Million	Other reserves £ Million	Retained earnings £ Million	Total invested equity £ Million	Non-controlling interest £ Million	Total equity £ Million
Balance as at 1 January 2009		**1,500.0**	**119.0**	**1,312.6**	**2,931.6**	**258.5**	**3,190.1**
Profit for the year		—	—	133.1	133.1	—	133.1
Other comprehensive income		—	122.4	(6.3)	116.1	—	116.1
Transfers to / (from) non distributable reserves	28	—	25.3	(25.3)	—	—	—
Movement in demerger reserve	28	—	143.3	—	143.3	—	143.3
Movement in net assets of Direct Line Versicherung AG		—	1.4	(3.4)	(2.0)	—	(2.0)
Balance as at 31 December 2009		**1,500.0**	**411.4**	**1,410.7**	**3,322.1**	**258.5**	**3,580.6**
Loss for the year		—	—	(271.9)	(271.9)	—	(271.9)
Other comprehensive income		—	59.5	8.0	67.5	—	67.5
Transfers to / (from) non distributable reserves	28	—	14.0	(14.0)	—	—	—
Movement in demerger reserve	28	—	102.2	—	102.2	—	102.2
Movement in net assets of Direct Line Versicherung AG		—	3.3	0.4	3.7	—	3.7
Balance as at 31 December 2010		**1,500.0**	**590.4**	**1,133.2**	**3,223.6**	**258.5**	**3,482.1**
Profit for the year		—	—	249.0	249.0	—	249.0
Other comprehensive income		—	91.2	(0.6)	90.6	—	90.6
Transfers (from) / to non distributable reserves	28	—	(167.3)	167.3	—	—	—
Movement in demerger reserve	28	—	55.9	—	55.9	—	55.9
Movement in net assets of Direct Line Versicherung AG		—	5.0	(11.3)	(6.3)	—	(6.3)
Balance as at 31 December 2011		**1,500.0**	**575.2**	**1,537.6**	**3,612.8**	**258.5**	**3,871.3**
Profit for the period		—	—	82.8	82.8	—	82.8
Other comprehensive income		—	(3.5)	(2.4)	(5.9)	—	(5.9)
Dividends		—	—	(800.0)	(800.0)	—	(800.0)
Transfers to / (from) non distributable reserves	28	—	16.9	(16.9)	—	—	—
Movement in demerger reserve	28	—	24.6	—	24.6	—	24.6
Movement in net assets of Direct Line Versicherung AG		—	0.4	(9.0)	(8.6)	—	(8.6)
Balance as at 30 June 2012		**1,500.0**	**613.6**	**792.1**	**2,905.7**	**258.5**	**3,164.2**

DIRECT LINE INSURANCE GROUP PLC
COMBINED CASH FLOW STATEMENT

	Notes	Six months ended 30 June 2012 £ Million	Six months ended 30 June 2011 £ Million (unaudited)	Year ended 31 December 2011 £ Million	Year ended 31 December 2010 £ Million	Year ended 31 December 2009 £ Million
Net cash (used by) / generated from operating activities before investment of insurance assets	35	**(414.3)**	**(165.8)**	**(359.8)**	**89.2**	**(178.1)**
Cash generated from / (used by) investment of insurance assets	35	2,239.9	(673.9)	38.8	486.0	875.7
Net cash generated from / (used by) operating activities		**1,825.6**	**(839.7)**	**(321.0)**	**575.2**	**697.6**
Cash flows from investing activities						
Proceeds on disposal of property, plant and equipment		—	—	1.2	0.1	1.6
Purchases of property, plant and equipment	17	(48.4)	(3.2)	(7.5)	(5.2)	(8.4)
Purchases of intangible assets	16	(39.6)	(30.1)	(119.8)	(26.2)	(8.1)
Net cash flows from disposal of subsidiary and joint venture	19	—	(0.1)	(0.1)	—	330.9
Net cash (used by) / generated from investing activities		**(88.0)**	**(33.4)**	**(126.2)**	**(31.3)**	**316.0**
Cash flows from financing activities						
Dividends paid		(800.0)	—	—	—	—
Repayments of borrowings		(246.4)	(0.2)	(205.5)	(0.9)	(0.8)
Proceeds on issue of subordinated debt		493.0	—	—	—	—
Proceeds from borrowings		—	—	205.0	—	—
Net cash used by financing activities		**(553.4)**	**(0.2)**	**(0.5)**	**(0.9)**	**(0.8)**
Net increase / (decrease) in cash and cash equivalents		**1,184.2**	**(873.3)**	**(447.7)**	**543.0**	**1,012.8**
Cash and cash equivalents at the beginning of the period	25	1,309.6	1,763.5	1,763.5	1,225.9	238.5
Effect of foreign exchange rate changes		(11.9)	14.3	(6.2)	(5.4)	(25.4)
Cash and cash equivalents at the end of the period	25	**2,481.9**	**904.5**	**1,309.6**	**1,763.5**	**1,225.9**

Corporate information

Direct Line Insurance Group plc (the "**Company**") is a public limited company incorporated in the United Kingdom. The address of the registered office is Churchill Court, Westmoreland Road, Bromley BR1 1DP, England.

The Company, formerly called RBS Insurance Group Limited, was incorporated on 26 July 1988 as a private limited company with registered number 02280426 as a wholly-owned subsidiary of The Royal Bank of Scotland Group plc. RBS Group comprises The Royal Bank of Scotland Group plc and its subsidiaries.

In 2009, RBS Group committed to the European Commission to sell its insurance business as a condition of its receipt of State Aid. To comply with this requirement, RBS Group must cede control of the Company by the end of 2013 and must have divested its entire interest by the end of 2014.

1. ACCOUNTING POLICIES

Basis of preparation

The combined financial information presented has been prepared for the combined group which comprises the Company and its subsidiaries (together the "**Group**"). The combined financial information has been prepared on a historical cost basis except for investment properties and those financial instruments that have been measured at fair value.

The combined financial information has been prepared in accordance with the requirements of the Prospectus Directive regulation and the Listing Rules in accordance with this basis of preparation. The basis of preparation describes how the financial information has been prepared in accordance with IFRS as adopted by the EU except as described below.

IFRS as adopted by the EU does not provide for the preparation of combined financial information and accordingly, in preparing the combined financial information, certain accounting conventions commonly used in the preparation of historical financial information for the inclusion in investment circulars as described in the Annexure to SIR 2000 (Investment Reporting Standards applicable to public reporting engagements on historical financial information) issued by the UK Auditing Practices Board have been applied. The application of these conventions results in the following material departure from IFRS as adopted by the EU:

- The Group has incurred certain costs in respect of services provided to the Group by RBS Group that were incurred but not invoiced by RBS Group. The Conceptual Framework for Financial Reporting, paragraph 4.49, gives guidance that expenses should be recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen. As there is no contractual liability to pay and therefore no liability has arisen in connection with these costs, the costs would not be recorded in the combined financial information of the Group under IFRS.
- The combined financial information includes these costs in order to present the cost base of the Group during the period covered by the combined financial information. As these cost allocations did not result in a corresponding cash payment, they are offset by an entry in equity, described as 'demerger reserves', and are reflected in the notes to the cash flow statements (Note 35) within 'non cash movement in demerger reserve'.

In all other respects, IFRS as adopted by the EU has been applied.

The Group was formed on 2 April 2012 when the Company acquired Direct Line Versicherung AG. Prior to this date, the Group was not held by a single legal entity and accordingly, consolidated financial statements do not exist. The combined financial information has been prepared using merger accounting principles, as if the transaction that gave rise to the formation of the Group had taken place at the beginning of the comparative period. Under these principles, the combined financial information has been prepared as if the Company were the holding company of Direct Line Versicherung AG from 1 January 2009, the date of the beginning of the comparative period. The assets, liabilities and the profit or loss of the Company and its subsidiaries, and of Direct Line Versicherung AG have been combined. All transactions

1. ACCOUNTING POLICIES (Continued)

and balances between the entities included within the Group have been eliminated. The combined financial information reflects a liability payable to RBS Group at each period end prior to acquisition for the Direct Line Versicherung AG consideration. As the basis of preparation represents a reorganisation of entities under common control, it is therefore outside the scope of IFRS 3, Business Combinations. Accordingly, as permitted by IAS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors', it has been accounted for as a group reorganisation.

Adoption of new and revised standards

There have been no new or revised standards adopted in the period.

1.1 Basis of combination

The combined financial information comprises the financial information of each of the companies of the Group as at 30 June 2012 and 2011, and 31 December 2011, 2010 and 2009.

Where necessary, adjustments have been made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group. The policies set out below have been applied consistently throughout all the periods presented to items considered material to the combined financial information.

1.2 Foreign currencies

The Group's combined financial information is presented in sterling which is the presentation currency of the Group. Group entities record transactions in the currency of the primary economic environment in which they operate (their functional currency) at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates ruling at the balance sheet date. Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in the income statement except for differences arising on hedges of net investments in foreign operations. Non-monetary items denominated in foreign currencies that are stated at fair value are translated into the relevant functional currency at the foreign exchange rates ruling at the dates the values are determined. Translation differences arising on non-monetary items measured at fair value are recognised in profit or loss except for differences arising on available-for-sale non-monetary financial assets, for example equity shares, which are recognised in other comprehensive income.

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into sterling at the foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised in the combined statement of other comprehensive income. The amount accumulated in equity is reclassified from equity to the combined income statement on disposal or partial disposal of a foreign operation.

1.3 Contract classification

Insurance contracts are those contracts where the Group (the insurer) has accepted significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholders if a specified uncertain future event (the insured event) adversely affects the policyholders.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire.

1. ACCOUNTING POLICIES (Continued)

1.4 Revenue recognition

Premiums earned

Insurance and reinsurance premiums comprise the total premiums receivable for the whole period of cover provided by contracts incepted during the financial year, adjusted by an unearned premium provision, which represents the proportion of the premiums that relate to periods of insurance after the balance sheet date. Unearned premiums are calculated over the period of exposure under the policy, on a daily basis, 24ths basis or allowing for the estimated incidence of exposure under policies. Insurance premiums exclude insurance premium tax or equivalent local taxes.

Premiums collected by intermediaries or other parties, but not yet received, are assessed based on estimates from underwriting or past experience, and are included in insurance premiums. Insurance premiums exclude insurance premium tax or equivalent local taxes and are shown gross of any commission payable to intermediaries or other parties.

The Group's long-term assurance contracts include whole-life and term assurance contracts that are expected to remain in force for an extended period of time. These contracts insure events associated with human life (for example death or the occurrence of a critical illness). These are recognised as revenue when they become payable by the contract holder. Premiums are shown before the deduction of commission.

Investment return

Interest income on financial assets is determined using the effective interest rate method. The effective interest rate method is a way of calculating the amortised cost of a financial asset (or group of financial assets) and of allocating the interest income over the expected life of the asset. In the case of financial assets classified as available-for-sale, estimates are based on the straight-line method, which management has determined is a close approximation to the effective interest rate.

Rental income from investment properties is recognised in the income statement on a straight-line basis over the period of the contract. Any gains or losses arising from a change in fair value are recognised in the income statement.

Instalment Income

Instalment income comprises the interest income earned on policyholder balances, where outstanding premiums are settled by a series of instalment payments. Interest is earned using an effective interest rate method over the term of the policy.

Other operating income

Solicitors' referral fee income

Invoices relating to this activity are issued on a monthly basis for revenue receivable from third parties, and the revenue is recognised in full on the date of the invoice. With respect to the fixed term contracts, monthly invoices are issued to the third parties in arrears. The revenue for the current month is accrued for and recognised immediately. The arrangements are contractual and the cost of providing the service is recognised as the service is rendered.

Vehicle replacement referral fee income

Vehicle replacement referral fee income comprises fees in respect of referral income received when a customer or a non-fault policy holder (claimant) of another insurer has been provided with a hire vehicle from a preferred supplier. Income is recognised immediately when the customer or claimant is provided with the vehicle hire.

1. ACCOUNTING POLICIES (Continued)

Vehicle recovery, repairs and management systems income

Fees in respect of services for vehicle recovery are recognised as the right to consideration, and accrue through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable.

The Group's income also comprises vehicle repair services provided to other third-party customers. Income in respect of repairs to vehicles is recognised upon completion of the service. The price is determined using market rates for the services and materials used after discounts have been deducted where applicable.

Management systems income represents the sale of tracking units, installation services and monitoring services. Revenue is recognised immediately, with the exception of the non-cancellable network subscriptions receivable in advance, which are classified as deferred income in the balance sheet and recognised on a straight-line basis over the stated term of the subscription.

Other income

Commission fee income in respect of services is recognised when a policy has been placed and incepted. Income is stated excluding applicable sales taxes.

1.5 Insurance claims

Insurance claims are recognised in the accounting period in which the loss occurs. Provision is made for the full cost of settling outstanding claims at the balance sheet date, including claims incurred but not yet reported at that date, net of salvage and subrogation recoveries. Outstanding claims provisions are not discounted for the time value of money except for claims to be settled by PPOs established under the Courts Act 2003. A UK Court can award damages for future pecuniary loss in respect of personal injury or for other damages in respect of personal injury and may order that the damages are wholly or partly to take the form of PPOs. These are covered in more detail in notes 2.1 and 3.6.1. Costs for both direct and indirect claims handling expenses are also included.

Provisions are determined by management based on experience of claims settled and on statistical models which require certain assumptions to be made regarding the incidence, timing and amount of claims and any specific factors such as adverse weather conditions. When calculating the total provision required, the historical development of claims is analysed using statistical methodology to extrapolate, within acceptable probability parameters, the value of outstanding claims (gross and net) at the balance sheet date. Also included in the estimation of outstanding claims are factors such as the potential for judicial or legislative inflation. In addition an allowance is made for reinsurance assets deemed not recoverable.

Provisions for more recent claims make use of techniques that incorporate expected loss ratios and average claims cost (adjusted for inflation) and frequency methods. As claims mature, the reserves are increasingly driven by methods based on actual claim experience. The approach adopted takes into account the nature, type and significance of the business and the type of data available, with large claims generally being assessed separately. The data used for statistical modelling purposes is generated internally and reconciled to the accounting data.

The calculation is particularly sensitive to the estimation of the ultimate cost of claims for the particular classes of business at gross and net levels and the estimation of future claims handling costs.

Actual claims experience may differ from the historical pattern on which the actuarial best estimate is based and the cost of settling individual claims may exceed that assumed. As a result, the Group sets reserves at a margin above the actuarial best estimate. This amount is recorded as claims reserves.

A liability adequacy provision is made for unexpired risks arising where the expected value of net claims and expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned premium reserve in relation to such policies after the deduction of any acquisition costs

1. ACCOUNTING POLICIES (Continued)

deferred and other prepaid amounts (e.g. reinsurance). The expected value is determined by reference to recent experience and allowing for changes to the premium rates. The provision for unexpired risks is calculated separately by reference to classes of business that are managed together after taking account of relevant investment returns.

1.6 Reinsurance

The Group has reinsurance treaties and other reinsurance contracts that transfer significant insurance risk.

The Group cedes insurance risk by reinsurance in the normal course of business, with the arrangement and retention limits varying by line of business. Outward reinsurance premiums are generally accounted for in the same accounting period as the premiums for the related direct business being reinsured. Outward reinsurance recoveries are accounted for in the same accounting period as the direct claims to which they relate.

Reinsurance assets include balances due from reinsurance companies for ceded insurance liabilities. Amounts recoverable from reinsurers are estimated in a consistent manner with the outstanding claims provisions or settled claims associated with the reinsured policies and in accordance with the relevant reinsurance contract. Recoveries in respect of PPOs are discounted for the time value of money.

A reinsurance bad debt provision is assessed in respect of reinsurance debtors, to allow for the risk that the reinsurance asset may not be collected or where the reinsurer's credit rating has been downgraded significantly. This also includes an assessment in respect of the ceded part of claims reserves to reflect the credit risk exposure to long-term reinsurance assets particularly in relation to periodical payments. This is effected by the Group reducing the carrying value of the asset accordingly and the impairment loss is recognised in the income statement.

1.7 Deferred acquisition costs

Acquisition costs relating to new and renewing insurance policies are matched with the earning of the premiums to which they relate. A proportion of acquisition costs incurred during the year are therefore deferred to the subsequent accounting period to match the extent to which premiums written during the year are unearned at the balance sheet date.

The principal acquisition costs deferred are direct advertising expenditure, third party administration fees, commission paid and costs associated with telesales and underwriting staff.

1.8 Goodwill and other intangible assets

Acquired goodwill, being the excess of the cost of an acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary, associate or joint venture acquired, is initially recognised at cost and subsequently at cost, less any accumulated impairment losses. Goodwill arising on the acquisition of subsidiaries and joint ventures is included in the balance sheet category 'goodwill and other intangible assets'. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to the income statement over the assets' economic lives using methods that best reflect the pattern of economic benefits and is included in other operating expenses. The estimated useful economic lives are as follows:

Computer software . . . . . 5 years

Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll costs, the costs of materials and services, and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as

1. ACCOUNTING POLICIES (Continued)

intended. During and after development, accumulated costs are reviewed for impairment against the projected benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability is expensed as incurred as are all training costs and general overheads. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

1.9 Property, plant and equipment

Items of property, plant and equipment (except investment property–see accounting policy 1.11) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for separately.

Depreciation is charged to the income statement on a straight-line basis so as to write off the depreciable amount of property, plant and equipment over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Land is not depreciated. Estimated useful lives are as follows:

Freehold and long leasehold buildings	50 years or the period of the lease if shorter
Vehicles	5 years
Computer equipment	Up to 5 years
Other equipment, including property adaptation costs	4 to 15 years

The gain or loss arising from the derecognition of an item of property, plant and equipment, is determined as the difference between the disposal proceeds if any, and the carrying amount of the item.

1.10 Impairment of intangible assets, goodwill and property, plant and equipment

At each reporting date, the Group assesses whether there is any indication that its intangible assets, goodwill or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss, if any. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. If an asset does not generate cash flows that are independent from those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. The recoverable amount of an asset is the higher of its fair value, less costs to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit, discounted at a rate that reflects market interest rates, adjusted for risks specific to the asset or cash-generating unit that have not been reflected in the estimation of future cash flows.

If the recoverable amount of an intangible or a tangible asset is less than its carrying value, an impairment loss is recognised immediately in the income statement and the carrying value of the asset is reduced by the amount of the impairment loss.

A reversal of an impairment loss on intangible assets or property, plant and equipment is recognised as it arises provided the increased carrying value does not exceed the carrying amount that would have been determined had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

1.11 Investment property

Investment property comprises freehold and long-leasehold properties that are held to earn rentals or for capital appreciation or both. Investment property is not depreciated but is stated at fair value based on valuations by independent registered valuers. Fair value is based on current prices for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognised in the income statement.

Investment properties are derecognised when either they have been disposed of, or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognised in the income statement in the year of retirement or disposal.

1. ACCOUNTING POLICIES (Continued)

1.12 Financial assets

Financial assets are classified as held-to-maturity, available-for-sale, designated as at fair value through profit or loss, or loans and receivables. The Group only has available-for-sale financial assets, loans and receivables, and designated as at fair value through profit or loss.

Available-for-sale–Financial assets that are not classified as designated as at fair value through profit or loss, or loans and receivables, are classified as available-for-sale. Financial assets can be designated as available-for-sale on initial recognition. Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Impairment losses and exchange differences resulting from retranslating the amortised cost of foreign currency monetary available-for-sale financial assets are recognised in profit or loss, together with interest calculated using the effective interest rate method. Other changes in the fair value of available-for-sale financial assets are reported in a separate component of shareholders' equity until disposal, when the cumulative gain or loss is recognised in the income statement.

Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date; all other regular way purchases are recognised on trade date.

A financial asset 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. The appropriate quoted market price for an asset held is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. If conditions have changed since the time of the transaction (e.g. a change in the risk-free interest rate following the most recent price quote for a corporate bond), the fair value reflects the change in conditions by reference to current prices or rates for similar financial instruments, as appropriate.

The valuation methodology described above uses observable market data.

If the market for a financial asset is not active, the Group establishes fair value by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the Group uses that technique.

The fair value of investments in equity instruments that do not have a quoted market price in an active market and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument are reliably measurable if:

(a) the variability in the range of reasonable fair value estimates is not significant for that instrument; or

(b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.

Loans and receivables–Non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables, except those that are classified as available-for-sale or designated as at fair value through profit or loss. Loans and receivables are initially recognised at fair value plus directly related transaction costs and are subsequently measured at amortised cost using the effective interest rate method, less any impairment losses.

1. ACCOUNTING POLICIES (Continued)

Insurance receivables comprise outstanding insurance premiums where the policyholders have elected to pay in instalments or amounts due from third parties, where they have collected or are due to collect the money from the policyholder.

Other loans and receivables principally comprise loans to related parties and other debtors.

Designated at fair value through profit or loss–Financial assets may be designated as at fair value through profit or loss only if such designation a) eliminates or significantly reduces a measurement or recognition inconsistency; or b) applies to a group of financial assets that the Group manages and evaluates on a fair value basis. Financial assets that the Group designates on initial recognition as being of fair value through profit or loss are recognised at fair value, with transaction costs being recognised in the income statement, and are subsequently measured at fair value. Gains and losses on financial assets that are designated as at fair value through profit or loss are recognised in the income statement as they arise.

Impairment of financial assets

At each balance sheet date the Group assesses whether there is any objective evidence that a financial asset or group of financial assets classified as available-for-sale or loans and receivables is impaired. A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Available-for-sale–When a decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss is removed from equity and recognised in the income statement. The loss is measured as the difference between the amortised cost of the financial asset and its current fair value. Impairment losses on available-for-sale equity instruments are not reversed through profit or loss, but those on available-for-sale debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event. Subsequent increases in the fair value of available-for-sale other investment funds are all recognised in equity.

Loans and receivables–If there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets, discounted at the effective interest rate of the instrument at initial recognition.

Impairment losses are assessed individually where significant or collectively for assets that are not individually significant.

Impairment losses are recognised in the income statement and the carrying amount of the financial asset or group of financial assets is reduced by establishing an allowance for the impairment losses. If in a subsequent period the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance.

For amounts due from policyholders, the bad debt provision is calculated based upon prior loss experience. For all balances outstanding in excess of three months, a bad debt provision is made. Where a policy is subsequently cancelled, the outstanding debt that is overdue is written off to the income statement and the bad debt provision is written back to the income statement.

Derivatives and hedging

Derivative financial instruments are recognised initially, and subsequently measured, at fair value. Derivative fair values are determined from quoted prices in active markets where available. Where there is no active market for an instrument, fair value is derived from prices for the derivative's components using appropriate pricing or valuation models.

1. ACCOUNTING POLICIES (Continued)

Gains and losses arising from changes in fair value of a derivative are recognised as they arise in the income statement unless the derivative is the hedging instrument in a qualifying hedge. The Group currently enters into a number of hedge relationships, including net investment, cashflow and fair value hedges.

Hedge relationships are formally documented at inception. The documentation identifies the hedged item, the hedging instrument and details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in cash flows and fair values attributable to the hedged risk, consistent with the documented risk management strategy, or if the hedging instrument expires or is sold, terminated or exercised, hedge accounting is discontinued.

In the hedge of a net investment in a foreign operation, the portion of foreign exchange differences arising on the hedging instrument determined to be an effective hedge is recognised directly in equity. Any ineffective portion is recognised in the income statement. Non-derivative financial liabilities as well as derivatives may be the hedging instrument in a net investment hedge.

In a cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised directly in equity. Any ineffective portion is recognised in the income statement.

In a fair value hedge, the gain or loss on the hedging instrument is recognised in the income statement. The gain or loss on the hedged item attributable to the hedged risk is recognised in the income statement and, where the hedged item is measured at amortised cost, adjusts the carrying amount of the hedged item.

1.13 Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits with banks, together with short-term highly-liquid investments that are readily convertible to known amounts of cash, and subject to insignificant risk of change in value.

Borrowings comprising bank overdrafts and group loans are measured at amortised cost using the effective interest method.

1.14 Financial liabilities

Amortised cost–Financial liabilities are initially recognised at fair value net of transaction costs incurred. Other than derivatives which are recognised and measured at fair value, all other financial liabilities are subsequently measured at amortised cost using the effective interest method.

1.15 Provisions

Regulatory levies

The Group accrues for all insurance industry levies, such as the Financial Services Compensation Scheme and Motor Insurance Bureau in the UK, as a provision in the balance sheet and not within insurance liabilities. The levy accruals are based on past underwriting levels at the best estimate rate given the available information at the balance sheet date. They are charged to the income statement as an expense.

1.16 Leases

Payments made under operating leases are charged to the income statement on a straight-line basis over the term of the lease.

1.17 Pensions and other post-retirement benefits

The Group provides post-retirement benefits in the form of pensions and healthcare plans to eligible employees.

1. ACCOUNTING POLICIES (Continued)

Contributions to the Group's defined contribution pension scheme are recognised in the income statement when payable. As described in note 33, the Group's defined benefit pension scheme was closed in 2003. Scheme liabilities are measured on an actuarial basis, using the projected unit credit method and discounted at a rate that reflects the current rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities.

Scheme assets are measured at their fair value. Any surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). The current service cost and any past service costs together with the expected return on scheme assets, less the unwinding of the discount on the scheme liabilities, is charged to operating expenses. Actuarial gains and losses are recognised in full in the period in which they occur outside the income statement and presented in other comprehensive income.

1.18 Taxation

Provision is made for taxation at current enacted rates on taxable profits, arising in income or in equity, taking into account relief for overseas taxation where appropriate.

Deferred taxation is accounted for in full for all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes, except in relation to overseas earnings where remittance is controlled by the Group, and goodwill.

Deferred tax assets are only recognised to the extent that it is probable that they will be recovered.

1.19 Share-based payments

RBS Group awards share-based payments to certain employees of the Group. Equity-settled share-based payments are measured at fair value (excluding the effect of non market-based vesting conditions) at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, adjusted for the effect of non market-based vesting conditions. The fair value of an option is estimated using valuation techniques which take into account its exercise price, its term, the risk free interest rate and the expected volatility of the market price of The Royal Bank of Scotland Group plc's shares.

Given that the Group's employees directly benefit from participation in these plans, the expense incurred by RBS Group for options granted to the employees has been reflected in the Group's combined income statement as other operating expenses. The compensation expense recognised for share options plans was immaterial for June 2012 and June 2011 and December 2011, 2010 and 2009.

1.20 Capital Instruments

The Group classifies a financial instrument that it issues as a financial liability or an equity instrument in accordance with the substance of the contractual arrangement. An instrument is classified as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms, or as equity if it evidences a residual interest in the assets of the group after the deduction of liabilities.

1.21 Subordinated liabilities

Subordinated liabilities comprise subordinated dated loan notes, which are initially measured at the consideration received less related transaction costs. Subsequently, subordinated liabilities are measured at amortised cost using the effective interest rate method.

1.22 Accounting developments

The International Accounting Standards Board ("**IASB**") issued an amendment to IAS 12 'Income Taxes' in December 2010 to clarify that recognition of deferred tax should have regard to the expected manner of

1. ACCOUNTING POLICIES (Continued)

recovery or settlement of the asset or liability. The amendment and consequential withdrawal of SIC 21 'Deferred Tax: Recovery of Underlying Assets', effective for annual periods beginning on or after 1 January 2012, is not expected to have a material effect on the Group. This amendment is not currently endorsed by the EU, endorsement is expected in the fourth quarter of 2012.

IFRS 10 Consolidated Financial Statements, which replaces SIC-12 Consolidation–Special Purpose Entities and the consolidation elements of the existing IAS 27 Consolidated and Separate Financial Statements, was issued by the IASB in May 2011. The new standard adopts a single definition of control: a reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity to generate returns for the reporting entity. Effective for annual periods beginning on or after 1 January 2013, the new standard is not expected to have any effect on the Group.

In May 2011 the IASB issued amendments to IAS 27 Separate Financial Statements which comprises those parts of the existing IAS 27 that dealt with separate financial statements, effective for annual periods beginning on or after 1 January 2013. The amendment to this standard is not expected to have any effect on the Group.

IFRS 11 Joint Arrangements, which supersedes IAS 31 Interests in Joint Ventures, was issued by the IASB in May 2011. Joint operations are accounted for by the investor recognising its assets and liabilities including its share of any assets held and liabilities incurred jointly and its share of revenues and costs. Joint ventures are accounted for in the investor's consolidated accounts using the equity method. Effective for annual periods beginning on or after 1 January 2013, the Group does not have any joint arrangements at this time and therefore this standard is not expected to have any effect on the Group.

In May 2011 the IASB issued amendments to IAS 28 Investments in Associates and Joint Ventures to cover joint ventures as well as associates; both must be accounted for using the equity method. The mechanics of the equity method are unchanged. Effective for annual periods beginning on or after 1 January 2013, the amendments to this standard are not expected to have any effect on the Group.

IFRS 12 Disclosure of Interests in Other Entities covers disclosures for entities reporting under IFRS 10 and IFRS 11 replacing those in IAS 28 and IAS 27 and was issued by the IASB in May 2011. Entities are required to disclose information that helps financial statement readers evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries, in associates and joint arrangements and in unconsolidated structured entities. The new standard is effective for annual periods beginning on or after 1 January 2013, and is not expected to have any effect on the Group.

In May 2011 the IASB issued IFRS 13 Fair Value Measurement which sets out a single IFRS framework for defining and measuring fair value and requiring disclosures about fair value measurements, effective for annual periods beginning on or after 1 January 2013. The new standard will have an impact on the quantitative and qualitative disclosure requirements of financial assets and liabilities of the Group that are not covered by IFRS 7 Financial Instruments: Disclosures.

Amendments to IAS 1 Presentation of Items of Other Comprehensive Income that require items that will never be recognised in profit or loss to be presented separately in other comprehensive income from those that are subject to subsequent reclassification, was issued by the IASB in June 2011. The amendments are effective for annual periods beginning on or after 1 July 2012, and will have an impact on the disclosure requirements of the Group's financial statements.

Amendments to IAS 19 Employee Benefits were introduced which require the immediate recognition of all actuarial gains and losses eliminating the 'corridor approach'; interest costs to be calculated on the net pension liability or asset at the appropriate corporate bond rate; and all past service costs to be recognised immediately when a scheme is curtailed or amended. The amendments are effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted. The Group is reviewing the amendments to determine their effect on the Group's financial reporting.

In December 2011 the IASB issued amendments to IFRS 7 Financial Instruments: Disclosure–Offsetting Financial Assets and Financial Liabilities. The amended disclosure requirements are intended to enable

1. ACCOUNTING POLICIES (Continued)

the evaluation of the effect or potential effect of netting arrangements as permitted by IAS 32 (paragraph 42), on the financial statements. The amendments are effective for annual periods beginning on or after 1 January 2013 and are not expected to have any effect on the Group.

The IASB amended IAS 32 Financial Instruments: Presentation in December 2011 for the section dealing with offsetting a financial asset and a financial liability. Effective for annual periods beginning on or after 1 January 2014, to be applied retrospectively, this amendment is not expected to have any effect on the Group.

The IASB has published IFRS 9: Financial Instruments: recognition and measurement that will apply to financial years beginning on 1 January 2015. The new standard has not been adopted by the EU. The standard is a complete revision and will replace the current standard IAS 39, Financial Instruments: Recognition and Measurement. The standard reduces the number of valuation categories for financial assets and means that they are recognised at amortised cost or fair value through profit or loss. The rules for financial liabilities correspond to the existing rules in IAS 39 plus a supplement on how credit risk is presented when financial liabilities are measured at fair value. The change in the credit risk for financial liabilities designated at fair value according to the so-called fair value option is normally presented in other comprehensive income and not in the traditional income statement, provided that further inconsistencies do not arise in presentation of any eliminated changes in value.

The standard will be complemented by new rules for impairment of financial assets that are categorised as financial assets at amortised cost and new rules for hedge accounting. The adoption of IFRS 9, which the Group plans not to adopt before the year beginning on 1 January 2015, will impact both the measurement and disclosures of financial instruments.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial information. The Group's principal accounting policies are set out on pages 182 to 193. UK company law and IFRS require the directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard or interpretation, IAS 8 requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's Framework for the Preparation and Presentation of Financial Statements. The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results.

2.1 General insurance: outstanding claims provisions and related reinsurance recoveries

The Group makes provision for the full cost of outstanding claims from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and loss adjustment expenses. Outstanding claims provisions net of related reinsurance recoveries at 30 June 2012 amounted to £5,589.7 million (31 December 2011: £5,807.7 million; 2010: £6,311.0 million; 2009: £5,434.1 million).

The traditional method of settling a bodily injury claim is via an 'Ogden lump sum', calculated based on the estimated future earnings of the claimant and the annual cost of medical care required over the expected future time to retirement age/lifetime. Other estimates are also required for case management expenses, loss of pension, court protection fees, alterations to accommodation and transportation fees. The estimated future costs are discounted back to the settlement date using the 'Ogden discount rate', which is a prescribed rate set by the relevant government bodies. Currently this represents a 2.5% real discount rate.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

The Lord Chancellor has announced a review of the approach to setting the Ogden discount rate in light of the current economic climate and claim environment. Any reduction in the discount rate would significantly increase the cost of claims settled via an Ogden lump sum.

The Group holds provisions for a reduction in the Ogden discount rate at 30 June 2012 to 1.5% (31 December 2011: 1.5%; 2010: 1.5%; 2009: 2.5%), excluding PPOs (which are separately reserved for). The interaction of the relative costs of PPOs and Ogden amounts have been allowed for in the calculation of the Ogden discount rate adopted.

Outstanding claims provisions are not discounted for the time value of money except for those in respect of PPOs under the Courts Act 2003. PPOs give rise to additional claims costs which are in excess of those calculated based on the Ogden tables and discounting is applied to the total cost of the PPO and not just the additional cost. Total discounted reserves for claims which have already been settled by way of a PPO at 30 June 2012 are £266.2 million (31 December 2011: £203.9 million; 2010: £185.9 million; 2009: £91.6 million) gross and at 30 June 2012 are £108.1 million (31 December 2011: £80.3 million; 2010: £54.3 million, 2009: £26.1 million) net of reinsurance. The corresponding undiscounted amounts at 30 June 2012 are £944.6 million (31 December 2011: £730.4 million; 2010: £646.3 million; 2009: £275.7 million) gross and at 30 June 2012 are £354.9 million (31 December 2011: £245.1 million; 2010: £195.2 million; 2009: £61.8 million) net of reinsurance. Total discounted claims reserves estimated to be settled by PPOs in respect of both claims reported prior to the period end and incurred but not reported claims at 30 June 2012 are £1,268.1 million (31 December 2011: £1,166.5 million; 2010: £1,180.0 million) gross and at 30 June 2012 are £855.9 million (31 December 2011: £835.3 million; 2010: £826.6 million) net of reinsurance. The corresponding undiscounted amounts at 30 June 2012 are £4,218.8 million (31 December 2011: £3,856.9 million; 2010: £4,320.9 million) gross and at 30 June 2012 are £2,448.4 million (31 December 2011: £2,404.9 million; 2010: £2,659.6 million) net of reinsurance.

The amounts for 2012, 2011 and 2010 include a provision for estimated PPOs incurred but not reported, there was no such provision in 2009.

The value of claims with a periodical payment is calculated via a cash flow model. PPO claims are projected using the terms of the settlement, the assumed life expectancy, and adjusted for the inflation agreed in the settlement. Outstanding lump sums are estimated using the claims handlers' case estimates, for both the claim with the PPO and any other claims arising from the same accident. The average interval between the date of the last future cash flow being discounted and the end of the financial year as at 30 June 2012 is 50 years (31 December 2011: 50 years; 2010: 50 years; 2009: 40 years). This is calculated for each of the claims settled by PPO as the mean of the Group's and the claimant's expert medical advice on the claimant's life expectancy. Reinsurance is calculated on the accident's entire costs, and the net cash flows are discounted for the time value of money to allow for investment earnings.

In the majority of cases the inflation index agreed in the settlement is the Annual Survey of Hours and Earnings inflation, for which the long-term rate is assumed to be 4.5%. The rate of interest used for the calculation of present values as at 30 June 2012 is 4.5% (31 December 2011: 4.5%; 2010: 4.5%; 2009: 4.14%), which results in a real discount rate of 0.0%. All future payments in respect of settled PPOs are discounted to the current valuation date. All future payments in respect of incurred but not reported PPO claims are discounted to the assumed settlement date of each claim, rather than the current valuation date.

Details of sensitivity analysis to the discount rate applied to PPO claims are shown in note 3.7.1.

2.2 Impairment provisions–financial assets

Available-for-sale–the Group determines that available-for-sale financial assets are impaired when there has been a significant or prolonged decline in the fair value below its cost or if there is objective evidence that an event or events since initial recognition of the assets have adversely affected the amount or timing of future cash flows from the asset. The determination of what is significant or prolonged requires judgement. In making this judgement, the Group evaluates among other factors, the normal volatility of share price, the financial health of the investee, industry and sector performance, changes in technology and operational and financing cash flow. Impairment may be appropriate when there is evidence of deterioration in these factors.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

On a quarterly basis, the Group reviews whether there is any objective evidence that the direct investments in debt securities are impaired based on the following criteria:

- price performance of a particular debt security, or group of debt securities, demonstrating an adverse trend compared to the market as a whole;
- adverse movements in the credit rating for corporate debt; and
- actual, or imminent, default on coupon interest or nominal.

Impairment provision charges on debt securities available-for-sale financial assets at 30 June 2012 amounted to £nil (six months ended 30 June 2011 (unaudited): £nil; 31 December 2011: £2.0 million; 2010: £21.4 million; 2009: £nil).

Had all the declines in available-for-sale asset values met the criteria above, the Group would suffer a further £37.3 million loss in the six months ended 30 June 2012 (six months ended 30 June 2011 (unaudited): £37.6 million; years ended 31 December 2011: £37.3 million loss; 2010: £58.2 million loss; 2009: £102.3 million loss), being the transfer of the total available-for-sale reserve for unrealised losses to the income statement. These movements represent mark-to-market movements and where there is no objective evidence of any loss events that could effect future cash flows, no impairments are recorded for these movements.

2.3 Fair value

Financial assets classified as available-for-sale are recognised in the financial information at fair value. In the balance sheet, financial assets carried at fair value are included within available-for-sale debt securities and equity shares. Unrealised gains and losses on available-for-sale financial assets are recognised directly in other comprehensive income unless an impairment loss is recognised.

The fair value of all available-for-sale financial assets was determined using observable market input and as at 30 June 2012 amounted to £7,032.8 million (31 December 2011: £7,990.7 million; 2010: £7,867.1 million; 2009: £7,346.6 million). The judgements and assumptions adopted by management in the valuation of available-for-sale financial assets when a market is not active, require the use of valuation techniques. These valuation techniques involve a degree of estimation and are noted in note 1.12. Details on sensitivity analysis are shown in note 3.7.1.

2.4 Deferred acquisition costs

The Group defers a proportion of acquisition costs incurred during the year to subsequent accounting periods. Management use estimation techniques to determine the level of costs to be deferred, by category of business. Judgement is used to determine the types of cost that can be deferred and these are referred to in note 1.7. The total deferred acquisition costs as at 30 June 2012 amounted to £337.1 million (31 December 2011: £310.5 million; 2010: £299.5 million, 2009: £338.5 million). During 2012, management reviewed the costs included in the calculation of deferred acquisition costs and considers them to be appropriate, and have estimated that they are recoverable.

2.5 Goodwill

The Group capitalises goodwill arising on the acquisition of businesses as discussed in accounting policy 1.8. The carrying value of goodwill as at 30 June 2012 was £211.0 million (31 December 2011: £211.0 million; 2010: £221.2 million; 2009: £230.5 million).

Goodwill is the excess of the cost of an acquired business over the fair value of its net assets. The determination of the fair value of assets and liabilities of businesses acquired requires the exercise of management judgement; for example those financial assets and liabilities for which there are no quoted prices, and those non-financial assets where valuations reflect estimates of market conditions, such as property. Different fair values would result in changes to the goodwill arising and to the post-acquisition

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

performance of the acquisition. Goodwill is not amortised but is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units or groups of cash-generating units expected to benefit from the combination. Goodwill impairment testing involves the comparison of the carrying value of a cash-generating unit or group of cash-generating units with its recoverable amount. The recoverable amount is the higher of the unit's fair value and its value in use. Value in use is the present value of expected future cash flows from the cash-generating unit or group of cash-generating units. Fair value is the amount obtainable for the sale of the cash-generating unit in an arm's length transaction between knowledgeable, willing parties.

Impairment testing inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of cash-generating units; and the valuation of the separable assets of each business whose goodwill is being reviewed. Details on sensitivity analysis are shown in note 16.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK

3.1 Risk management overview

Risk management is at the heart of the insurance business. The Group issues contracts that accept insurance risk in return for a premium. The Group is also subject to investment risk (market risk and credit risk), other credit risk, liquidity risk, regulatory risk, operational risk and group risk.

From February 2012 the Group has operated under a bespoke Enterprise-Wide Risk Management ("**ERM**") framework. The Group benefits from services provided by specialist risk and audit teams and risk management procedures and controls which are applied across the Group.

The Group is supervised on a combined basis by the FSA, its lead regulator. The UK-regulated entities are supervised by the FSA, the Group's business in Italy is regulated by the ISVAP and the Group's business in Germany by the BaFin.

The Group's ability to successfully quantify risk exposure, and, as a result, price insurance products successfully, is subject to risks and uncertainties, including uncertainties in claims inflation estimation (including its progression), from bodily injury claims in particular; unanticipated legal and regulatory changes and costs; changes in social, market or consumer trends and behaviours, including claimant behaviour; potential inaccuracies in the data collected from internal and external parties and/or used within the modelling and pricing processes; incorrect or incomplete analysis of data; potentially inaccurate or inappropriate policy terms and conditions; inappropriate or incomplete purchase of reinsurance; changes in the internal operating environment within the Group; the selection of inappropriate pricing methodologies and models; investment return and reserve uncertainty and the uncertainties inherent in estimates and assumptions, including those used throughout the pricing and underwriting processes.

3.1.1 Risk management within the RBS Group

The management of risk is a fundamental management activity performed throughout all the RBS Group's operations. It is, therefore, critically important that the adequacy and effectiveness of the RBS Group's risk management processes are of the highest standard and subject to continuous review and enhancement.

The RBS Group has put in place a comprehensive risk management framework, predicated on a three lines of defence model, clearly separating risk management, risk oversight and risk assurance duties.

A number of high-level committees support the RBS Group's board in the effective measurement and management of risk.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

The Group has established its own risk management framework aligned to the RBS group policy framework.

3.1.2 Policy frameworks

3.1.2.1 RBS Group policy framework

Until February 2012, the Group operated under the RBS Group policy framework. The aim of the RBS Group policy framework is to provide an effective framework to standardise the presentation and control of RBS Group policy, including new policies and amendments. The Group employees had access to the RBS Group policies and policy standards through a single RBS Group intranet site.

RBS Group policies address all the major areas of risk to the RBS Group and the standards that must be met to enable those risks to be managed in line with RBS Group's risk appetite. All RBS Group policies must be approved by the RBS Group executive committee.

3.1.2.2 The Group policy framework

Since February 2012 the Group has operated under its own ERM framework. The aim of this framework is to provide a robust, proportionate, proactive and forward-looking process for risk management across the Group. A central component of this framework is the Group's policies and minimum standards which inform the business as to how it is required to conduct its activities and risk management processes. Where appropriate, the minimum standards are supported by detailed guidance.

3.2 The Group specific risk governance and oversight

3.2.1 The Direct Line Insurance Group plc Board ("the Board")

The Board oversees the business operations within the Group, ensuring competent and prudent management and the maintenance of adequate accounting and other procedures as well as compliance with statutory and regulatory obligations.

Specifically the following are key areas that the Board considers and must approve at least annually:

- the high level controls document;
- the Group risk appetite; and
- the Group risk profile, including the output from financial and other quantitative models (such as risk based capital modelling). This encompasses the ICAs and other capital related submissions to the supervisory authority where appropriate.

The Board has responsibility for understanding and approving the nature and level of risk assumed by the Group and the methodologies, approaches and assumptions used to identify, measure, manage, monitor, report, control and mitigate such risk. As such they approve the risk appetite of the Group as a whole, by risk type and for the main regulated insurance entities within it.

3.2.2 The Group governance model

The Group has adopted a "Three Lines of Defence" operating model. This approach is widely recognised as a best practice standard for companies in the financial services sector.

First line of defence: Business and support functions, responsible for:

- implementing and adhering to the risk strategy, risk appetite and wider risk framework;
- owning and managing risks within the agreed risk appetite and in compliance with the ERM framework; and
- providing assurance to policy owners that the policy framework is being adhered to.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

Second line of defence: Risk function, including compliance, responsible for:

- advising the Board on risk appetite and supporting the business in its application;
- determining, developing and helping to implement the ERM framework and tools, for agreement by the Board which the first line uses to discharge its responsibilities; and
- providing oversight, challenge and support to the first line on its management of risks.

Third line of defence: Internal audit, responsible for:

- providing independent assurance over the adequacy and effectiveness of the design and operation of the Group's governance, risk and control framework.

The governance structure connects the business and risk management function across the first and second lines of defence to provide a consistent approach to managing risk across the organisation. This includes various oversight committees which provide robust oversight of the ERM exposure.

3.2.2.1 Risk and audit committee ("Risk and Audit Committee")

The Risk and Audit Committee is a non-executive committee of the Board which meets a minimum of once a quarter. The committee operates under delegated authority from the Board with a remit which specifically encompasses the requirement to review and challenge risk and governance in more depth on behalf of the Board. In relation to risk management, the responsibilities of the committee are:

- to review and challenge the risk strategy and risk appetite and recommend matters to the Board for approval;
- to review, challenge and recommend the ERM framework and other associated governance frameworks to the Board as appropriate;
- to review and challenge the risk profile including the operational adequacy and effectiveness of the risk management operating model and internal control environment across the Group;
- to review the controls and procedures established by management for compliance with regulatory and financial reporting requirements and with the requirements of external regulators;
- to review and challenge the adequacy of the internal control framework through the receipt of internal audit plans and reports; and
- to review accounts and statements on risk management and reserving.

In addition, the committee is responsible for providing an opinion on the effectiveness of the risk management framework.

On 21 September 2012, the Risk and Audit Committee was replaced by two separate committees: an Audit Committee and a Board Risk Committee.

3.2.2.2 Executive Committee ("ExCo")

The Chief Executive Officer ("**CEO**") fulfils his responsibilities through the managing directors of the business and support functions who operate a range of committees and other fora to provide advice to delegated individuals to enable them to discharge their obligations within their area of responsibility (for example: pricing committees, loss ratio committees).

The detailed responsibilities of the ExCo that are relevant to risk management are:

- to consider and determine relevant recommendations on risk management matters including risk organisation, risk strategy, risk appetite, risk policy framework;
- to consider any relevant policies, processes and procedures for the effective management of risk across the organisation;

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

- to consider and determine relevant recommendations on limits by risk type for onward communication to the Risk and Audit Committee for review and challenge, and if appropriate, approval as required;
- to ensure that risk and capital considerations are incorporated within the strategic planning and budgeting processes and other decision making processes as appropriate; and
- to review, consider, discuss and understand all issues relating to the reinsurance arrangements or any other material risk mitigation strategies operated by the Group.

As part of this, the risk function produces a range of regular reporting including a report each month to the ExCo and the Board that covers breaches and exceptions to risk policy, relevant management information including quantified risks and details of any new and emerging risks.

The Chief Risk Officer ("**CRO**") is a member of the ExCo and has a reporting line to the CEO, with a right of access to the Risk and Audit Committee, assuring independence of the function.

3.2.2.3 Risk Management Committee ("RMC")

The RMC is responsible for reviewing current and potential risk exposures of the Group, against the Group's agreed risk appetite, promoting a risk aware culture and identifying any matters within its remit where action or improvement is needed or recommended.

The CRO, as Chair of the RMC, provides reports or escalates matters to the Board Risk Committee, as well as reporting regularly to ExCo.

3.2.2.4 Investment committee

The role of the investment committee is to propose, for approval by the Board, the investment policies and investment guidelines for the management of the funds. The international and life boards independently review and approve the investment guidelines of these entities in addition to the Group Board. Specifically the committee:

- sets the high level investment strategy through the investment policy and investment guidelines, giving due consideration to the potential risk profile, including liquidity requirements and associated capital impact of each subsidiary;
- reviews the return on funds invested having regard for the investment policies and investment guidelines;
- monitors the quality of advice in relation to the investment of funds and to ensure that the cost of it is reasonable; and
- reports to the boards of the regulated companies within the Group, as appropriate, on investment management performance.

3.2.2.5 Assets and Liability Management Committee ("ALCO")

In April 2012, ALCO was formed. Meetings are held at least quarterly with further meetings as required. The role of ALCO is to support the Finance Director with regards to capital and investment management. The responsibilities are:

- to review the capital required for the Group and monitoring available resources versus capital requirement agreed with the regulator;
- to monitor liquidity both in 'business as usual' and 'stressed' conditions; and
- to consider the best deployment of capital resources to maximise return on equity within agreed risk appetite (set by the Board).

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

The Finance Director reports to the Board on any material decisions he takes as a result of conclusions reached at ALCO meetings. Such material decisions will be confirmed with the CRO in advance of implementation.

3.2.2.6 Reserving review committee

Meetings will be held at least quarterly with further meetings as required. The role of the reserving review committee is to review, consider, discuss, understand and, as appropriate, oversee all issues relating to the actuarial reserving process for the UK and International regulated general insurance companies within the Group, including those issues impacting the financial/statutory reporting for these entities. The responsibilities are:

- oversight of the reserving process on at least a quarterly basis to ensure that the UK and International regulated entities remain adequately reserved;
- oversee that the technical claims and premium reserves being held by the UK and International general insurance entities in terms of adequacy and regulatory and statutory requirements, are in line with the Group's stated accounting policy and Board reserving policy statements;
- to consider the key reserving process issues, including but not limited to prior year reserve movements and performance relative to budget/forecast;
- to review changes in claims handling process and their effects on claims development patterns, management information and ultimate claims costs; and
- to review provisions for unallocated loss adjustment expense reserves and reinsurance bad debt provisions.

3.3 Enterprise-Wide Risk Management process

The ERM process within the Group ensures that risk management is a forward looking discipline, focused on facilitating appropriate and fair outcomes on a consistent and reliable basis for all stakeholders. The ERM process provides the Group with a consistent and holistic view of risk management.

To support the ERM framework, the risk appetite framework and the policy and minimum standard framework, the Group has developed a comprehensive toolkit comprising user guides, detailed guidance where appropriate and templates where appropriate to enable the end user to meet the requirements of the risk management techniques employed across the business.

3.3.1 Compliance with minimum standards

The business and support functions (the first line of defence) must comply with the ERM framework, including all policies and associated minimum standards which detail the minimum requirements for managing risk within the Group. To do this each ExCo member must:

- implement such processes as it deems appropriate and in accordance with the ERM framework to enable the identification, assessment, management, control, reporting and mitigation of its risk exposure;
- monitor compliance with the ERM framework;
- ensure key risks and any breaches of policies, minimum standards and/or risk appetite arising are identified and escalated for review and challenge by the risk function or higher as appropriate;
- ensure that any issues identified are managed, mitigated and resolved in a timely and appropriate manner to ensure that risk is managed within the Board's agreed risk appetite; and
- on at least a half-yearly basis, sign a control environment certificate in relation to their area of responsibility, including an assessment of their compliance with the relevant policies and Minimum Standards and risk management processes, following such reviews as are appropriate.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

The risk function separately analyses risk reports, aggregated as appropriate, breaches and other issues and matters to identify overall potential trends and key risks to help determine the Group's risk profile compared to its risk appetite, escalating any overall breaches and other issues for review and challenge by relevant risk fora as appropriate. Such fora, including the Risk and Audit Committee, are responsible for discussing, reviewing and challenging new, existing and emerging risks and issues, assisting in the formulation of action plans to mitigate them, including breaches of policy or risk appetite, and then monitoring their resolution and mitigation. As part of this, the risk function reports relevant information, including deviations, trends, key risks and actions to the ExCo and to the Board, through the Risk and Audit Committee and/or RMC.

A key part of the oversight of the first line of defence's compliance with the ERM framework and its associated policies and procedures, is a programme of risk based reviews and audits undertaken by the second and third lines of defence, with the results of such reviews being reported to relevant fora for consideration to help them determine and direct future risk management activity.

3.4 Risk appetite

Risk appetite is a measure of the amount of risk that the Group is willing to accept in pursuit of its strategic objectives. Whilst the risk appetite of individual business lines may vary, this variance should never cause the Group to be exposed to a level of risk outside its appetite. The risk appetite statements are aligned to strategic performance indicators used by the management. The statements are a core component of the Group's ERM framework and, hence, are cascaded through the Group into day-to-day processes, aligning business limits, key risk indicators ("**KRI**"s) and controls to the Board's high level risk appetite statements. Each of the risk appetite statements is supported by underlying sub-statements and a comprehensive suite of KRIs. Appropriate threshold levels for the indicators are determined using results from the risk-based capital model, loss experience and management experience, where appropriate. In the event of any indicator changing status suggesting that a risk may be falling outside of the agreed appetite boundaries, remedial action is required to be taken to return the risk to within the agreed appetite.

The risk appetite is defined in both quantitative and qualitative terms as not all risks faced by the Group are quantifiable.

3.5 Risk and capital management modelling

The Board has ultimate responsibility for ensuring that the Group has sufficient capital to meet its liabilities as they fall due. The Group carries out detailed capital modelling of its assets, liabilities and the key risks to which these are exposed. This modelling includes the Group's own assessment of its capital requirements for solvency purposes, in its submission of its ICA to the FSA in respect of its UK regulated entities. The ICA quantifies the insurance, market, credit, liquidity, operational and group risk that the UK regulated entities are undertaking.

The Board is closely involved in the ICA process and signs off on its assumptions and results.

3.6 Insurance risk

Insurance risk can arise from:

- fluctuations in the timing, frequency and severity of insured events and their ultimate settlement, relative to the expectations of the Group at the time of underwriting, including those driven by inaccurate pricing, inappropriate underwriting guidelines and terms and conditions, and holding inadequate reserves;
- inadequate reinsurance protection; and
- concentration of business leading to unexpected claim levels (frequency and severity) from a single source.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

The Group predominantly underwrites personal lines insurance including residential property, motor, assistance, creditor, travel and pet business. The Group also underwrites commercial risks primarily for low to medium risk trades within the SME market. Contracts are typically issued on an annual basis, which means that the Group's liability usually extends for a 12-month period, after which the Group is entitled to decline to renew or can impose renewal terms by amending the premium or other policy terms and conditions such as the excess as appropriate.

Until 6 July 2011, the Group underwrote long-term insurance falling within the business classes of life and annuity and permanent health. The products provided were mortgage life cover, fixed term life cover with critical illness, over-50s life cover and the life cover associated with the creditor business underwritten by the Group's general insurance business. Contracts were issued typically on a long-term basis, which means that the Group's liability can extend for a period ranging from five years up to fifty-two years.

For creditor insurance, contracts were issued either on a monthly renewable basis (regular premium) and can be amended or cancelled by the customer at any point during the contract or cover period of a loan (single premium). In the former case, the Group can cancel or amend the policy following a 90 day written notice period. In the latter case (these policies were withdrawn from sale in April 2009), the customer has the option to cancel the contract at any point but generally the Group is obligated for the full term of up to a maximum of ten years but typically three to five years.

3.6.1 Reserving risk

Reserving risk relates to both premiums and claims. It is the risk that reserves are assessed incorrectly such that either insufficient funds have been retained to pay or handle claims as the amounts fall due both in relation to those claims which have already been incurred (in relation to claims reserves) or will be incurred in future periods of insurance (in relation to premium reserves), or a surplus of funds have been retained resulting in opportunity costs.

Due to the uncertain nature and timing of the risks which the Group is exposed to by underwriting insurance products, it cannot precisely determine the amounts that it will ultimately pay to meet the liabilities covered by the insurance policies written or when those liabilities will be paid. As such, the Group's reserves may prove to be inadequate to cover the actual claims costs which are experienced, particularly when the settlement of liability or payments of claims may not occur until well into the future, for example, and in particular, for bodily injury claims.

The Group maintains technical provisions or reserves to cover the estimated cost of future claims payments and related administrative expenses with respect to losses or injuries which have been incurred but have not been fully settled at the balance sheet date or which may occur in the future against insurance policies which have already been written prior to the balance sheet date. This includes losses or injuries that have been reported to the Group and those that have not yet been reported. The claims reserves represent estimates of all expected future payments, including related expenses, to bring every claim which has occurred prior to the balance sheet date whether reported or not, to final settlement, and the premium provisions represent the higher of the unexpired premiums or the estimated ultimate cost of the Group's exposure to claims and associated administration expenses which occur after the balance sheet date against business which was written prior to such date.

The Group estimates reserves using a range of actuarial and statistical projections and assumptions across a range of variables such as the time required to learn of and settle claims, facts and circumstances known at a given time, estimates of trends in the number of claims or claims of certain types, estimated inflation in claims severity and expected future claims payment patterns. Estimates are also made in respect of other variable factors including estimated future investment returns, changes in the legal, social, economic and regulatory environments, results of litigation, changes in rehabilitation and mortality trends, inflation in medical care costs, future earnings inflation, the cost of repairs and replacement, general economic conditions and estimated future receipts from third parties such as salvage, subrogation and reinsurance recoveries as well as changes in internal claims handling processes.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

For claims which will take several years to settle, mainly bodily injury, illness and liability (both public and employers' liability), the Group estimates such provisions based on past experience as well as consideration of known or potential future changes. Unexpected events, such as changes in regulation, legislation or new court cases, may increase the frequency and/or severity of insurance claims substantially more than anticipated at the time the insurance policies were priced or provisions were set. The Group's employers' liability business is also exposed to the risk of disease related claims in respect of currently unknown exposures being identified at a (much later) future date.

While most of the Group's technical reserves are held on an undiscounted basis and, therefore, do not allow for the investment income which will be earned on the reserves after the balance sheet date up until the claims are fully settled, the reserves held in respect of PPOs are held on a discounted basis. As such, the size and nature of the PPO reserves are exposed to the risk of changes in the timing of future cash flows or assumed discount rate/level of investment income. The Group subjects its reserves to independent external actuarial peer review on a periodic basis.

The Group's technical reserves are particularly susceptible to potential retrospective changes in legislation and new court decisions. For example, a change in the 'Ogden discount rate', would impact all relevant claims settled after that date, regardless of whether the insurance to which the claim relates was priced on that basis or not.

The recent increase in the utilisation of PPOs to settle bodily injury claims makes the estimation of technical reserves increasingly complex and uncertain due to the increased range of assumptions required, such as the future propensity of such settlement methods, estimated mortality trends for impaired lives, payment patterns, investment income and the impact of reinsurance recoveries which will occur many years into the future with a resultant increase in the associated credit or other non-payment risk. The fact that these claims take many years to ultimately settle increases the uncertainty around their estimation.

Reserving risk is controlled through a range of processes, the most significant ones being:

- regular periodic reviews of the claims and premium/liability adequacy reserves for the main classes of business by the internal actuarial team;
- the use of external actuaries to periodically peer review the actuarial best estimate reserves on classes reviewed internally and to complete external actuarial reviews on the vast majority of the remaining reserves;
- accompanying all reserve reviews with actuarial assessment of the uncertainties through a variety of techniques including bootstrapping and scenario analysis;
- oversight of the reserving process by relevant senior management and the Board;
- regular reconciliation of the data used in the actuarial reviews against general ledger data and reconciliation of the claims data history against the equivalent data from prior reviews; and
- assess the volatility in the reserves and hence help the Board set management best estimate reserves which it feels comfortable with.

3.6.2 Claims management risk

Claims management risk is the risk that claims are paid or handled inappropriately.

Claims are managed utilising a range of IT system-driven controls coupled with manual processes outlined in detailed policies and procedures to ensure claims are handled in an appropriate, timely and accurate manner.

Each member of staff has a specified handling authority, with controls preventing them handling or paying claims outside of their authorities, as well as controls to mitigate the risk of paying invalid claims. In addition, there are various outsourced claims handling arrangements all of which are monitored closely by management, with similar principles applying in terms of the controls and procedures.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

Loss adjustors are used in certain circumstances to handle claims to conclusion. This involves liaison with the policyholder, third parties, suppliers and the claims function.

A process is in place in the UK business to deal with severe weather and other catastrophic events, known as the Surge Demand Plan ("**SDP**"). A surge is the collective name given to an incident which significantly impacts the volume of claims reported to the Group's claims functions. The plan covers SDP triggers, stages of incident, operational impact, communication and management information monitoring of the impact.

Specialist bodily injury claims teams in the UK are responsible for handling these types of losses with the nature of handling dependent on the level and type of claim. Where applicable they are referred to the technical and large loss teams who also deal with all other claim types above defined limits or within specific criteria.

3.6.3 Underwriting and pricing risk: General insurance

Underwriting and pricing risk is the risk that inappropriate business will be written and/or inappropriate prices charged. The classes and sectors of business written, the underwriting criteria and relevant limits, help define the Group's underwriting risk appetite.

The Group manages this risk through a wide range of processes and fora, including:

- underwriting guidelines which exist for all business transacted restricting the types and classes of business that may be accepted;
- exception reports and other underwriting monitoring tools;
- comprehensive internal quality assurance programmes;
- pricing policies which are set by management and implemented through pricing committees by product line and by brand;
- central control, within pricing and underwriting teams, of policy wordings and any subsequent changes;
- the insurance risk framework that involves, among other things, regular minuted meetings where insurance risk is discussed, and additional meetings where detailed pricing, claims and reserving data and information are examined and discussed;
- weekly monitoring within the business of key performance indicators by product and brand;
- formal monthly monitoring and reporting to the ExCo, by product and brand; and
- annual budgeting and forecasting cycle, with sign off at the ExCo level.

The following paragraphs explain the frequency and severity of specific risks and the source of uncertainty for each class of business:

a) Motor insurance contracts

The causes of motor claims are primarily theft of, or from, the vehicle, accidental damage to the vehicle, third-party property damage and third-party bodily injury. To meet statutory requirements, policies of insurance written in the UK provide unlimited exposure for policyholders' liability at law for third-party bodily injury and reinsurance is purchased for the unlimited element over a suitable deductible. Motor liability insurance policies underwritten by the international businesses are governed by local laws and liability limits are capped (except for green card business where liability is unlimited). Reinsurance is purchased to reduce the retention to substantially below the prescribed limits.

Claims experience is subject to variation based on a significant number of factors, such as the experience of the drivers, the type of vehicle, the area and weather events. Contracts are typically issued on an annual basis, which means that liability usually extends for a 12-month period, after which the Group is entitled to

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

decline to renew or can impose renewal terms by amending the premium or terms and conditions including the excess or both.

There are various sources of uncertainty which will impact the Group's experience under motor insurance, including operational risk, reserving risk, investment returns, premium rates not matching claims inflation rates (particularly for bodily injury claims where frequency and severity are carefully monitored), the social, economic and legislative environment and reinsurance failure risks. Legislative risks for example in the UK, PPOs under the Courts Act 2003 and the associated longevity and discounting risks, and reviews of the Ogden tables used when setting lump sum bodily injury claim awards, including the associated discount rate, are all carefully monitored. The Group has documented risk policies, coupled with governance frameworks to oversee and control these risks. In addition, the Group is exposed to other potential changes such as those which might be introduced by the competition commission.

b) Residential property insurance contracts

The major claim perils for residential property insurance are theft, flood, escape of water, fire, storm, subsidence, liability and various types of accidental damage.

All contracts are typically written on an annual basis which means the Group's commitment is usually for a 12-month period, after which the Group can decline to renew or can impose special renewal terms through increased premiums or amending the terms and conditions including the excess or both.

The major source of uncertainty in the performance of the Group's property account is the volatility of the weather. Weather in the UK can affect the following causes of claims: flood, storm, escape of water following freezing (burst pipes) and subsidence. The Group maintains detailed, documented and active flood and subsidence strategies in order to control these exposures. Long-term exposure to potential climate change and associated risks is also closely monitored.

Over a longer period the strength of the economy is also a factor. During tougher times, as more businesses close down and unemployment increases, arson, theft and similar types of claims tend to increase.

There are many other sources of uncertainty which include operational, reserving, pricing and reinsurance issues. However, the Group has documented risk policies, coupled with governance frameworks to oversee and control these risks and hence minimise losses.

c) Commercial motor insurance contracts

Commercial motor insurance contracts can include individual commercial vehicles, fleets of vehicles for businesses or motor trade risks. The causes of commercial motor claims are primarily theft of, or from, the vehicle, personal accident, accidental damage to the vehicle, third-party property damage and third-party bodily injury. To meet statutory requirements, policies of insurance in the UK provide unlimited exposure for policyholders' liability at law for third-party bodily injury and reinsurance is purchased for the unlimited element over a suitable deductible.

Claims experience is subject to variation based on a wide number of factors, the principal ones are the experience of the drivers, type of vehicles and use. Contracts are typically issued on an annual basis, which means that the Group's liability extends to a 12-month period, after which the Group is entitled to decline to renew or can impose renewal terms by amending the premium, terms, excesses or a combination.

Motor liability insurance policies underwritten by the international businesses (Italy only) are governed by local laws and liability limits are capped. Extensive proportional and non-proportional reinsurance is purchased to reduce the retention and volatility of the account.

d) Commercial other insurance contracts

Commercial claims come mainly from property loss or damage, business interruption and losses arising from the negligence of the insured (liability insurance).

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

Property loss/damage claims come from causes such as fire, theft, storm, flood and other defined perils. Business interruption losses come from the loss of income, revenue and/or profit as a result of the cause of the property damage claim. These covers are generally written on a sum insured basis based on the values at risk.

Liability insurance can be broken down between employers' liability and public/products liability. The first covers employees for injury caused as a result of the insured's negligence. Public/products liability indemnifies the insured against any claims made by a third party for injury and/or damage as a result of the insured's negligence. Employers' liability has a standard limit of indemnity of £10 million plus authorised costs, but can be increased to £25 million for larger policyholders on request.

Public/products liability generally has a limit of up to £5 million, but can be increased to £10 million on request.

Insurance contracts are typically issued on an annual basis which means that the Group's liability is limited to a 12-month period, after which the Group can decline to renew the policy or can impose renewal terms such as increasing the premium or applying special terms such as an increased policy excess. However, as liability insurance is written on an occurrence basis, these covers are still subject to claims that manifest over a substantial period of time, but where the loss was in existence during the life of the policy (for example long-tail disease claims such as asbestosis).

There are a number of uncertainties which will impact the Group's general liability account. These include changes in the social, economic and legislative environment and, in particular, court judgments and legislation (for example, periodical payment orders under the Courts Act 2003, a review of the Ogden tables used by courts when setting bodily injury claim values), significant events (for example, terrorist attacks) and any emerging new heads of damage or types of claim that are not envisaged when the policy is written. This includes exposure to disease claims not realised/anticipated at the inception of the policy where exposure occurs during the policy period but symptoms and hence claims do not occur for many years into the future.

There are many other sources of uncertainty which include operational, reserving and reinsurance issues. However, the Group has documented risk policies, coupled with governance frameworks to oversee and control these risks and hence minimise the losses.

e) Creditor insurance contracts

Creditor insurance contracts are designed to cover payments on secured or unsecured lending, whether for individuals or, in certain circumstances, for sole traders and nominated individuals in small commercial companies.

The causes of creditor insurance claims are loss of income through accident, sickness, unemployment or, for some coverages/policies, death.

The largest influence on claims experience is the economic environment. Contracts are issued either on a monthly renewable basis (regular premium) and can be amended or cancelled by the customer at any point during the contract, or by the Group following a 90-day written notice period or are issued for the full term of the loan (single premium policies were withdrawn from sale in April 2009). In the latter case, the customer has the option to cancel the contract at any point but generally the Group is obligated for the full term of up to a maximum of ten years but typically three to five years.

The main source of uncertainty is the economic environment. A recession could lead to an increased number and cost of unemployment, accident and sickness claims. The policies are also exposed to increased death claims under the life cover element in the light of a severe pandemic.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

f) Travel insurance contracts

The main causes of travel insurance claims are medical expenses incurred as a result of the illness of or accident to the insured while on a trip, loss or theft of their personal possessions and cancellation of the trip before departure or curtailment during it due to illness or accident of the insured or a close relative.

Policies can either be on a single trip, or on an annual basis where all trips taken in a 12-month period are covered. Either way the risk factors are the age and state of health of the insured, the destinations of trips, the activities to be undertaken on the trips, and the durations.

The main sources of variability are large individual claims or events such as motor accidents including coach crashes, natural catastrophes or acts of terrorism. The Group has documented risk policies, coupled with governance frameworks to oversee and control these risks and hence minimise them.

g) Pet insurance contracts

The main cause of claim is the incurring of vet's fees to treat a sick dog or cat. Vet fee inflation is an issue that the Group deals with by rate and excess increases. Liability to third parties for accidents caused by dogs is also covered. Policies are renewable both annually or monthly. The species (cat or dog), age and breed of the animal are prime risk factors, as well as the postcode of its owner.

Large liability claims are few and far between, but there are many other sources of uncertainty which include operational, reserving, pricing and social and economic issues including vet fees inflation. The Group has documented risk policies and relevant frameworks to oversee and control these risks and hence to mitigate them.

h) Assistance contracts

Assistance contracts comprise motor vehicle rescue and Home Response 24. The major causes of assistance claims are vehicle breakdown or failure to start (rescue) or the need for emergency repairs of heating, drainage and plumbing. Contracts are typically issued on an annual basis which means that the Group's liability usually extends for a period of 12 months.

There are various sources of uncertainty which impact the Group's experience under assistance contracts. Adverse weather increases the number of both vehicle breakdown claims and home response claims due to the increased strain on heating and plumbing systems. The strength of the economy is also a factor. During times of economic difficulties, vehicle and property maintenance tends to decline, increasing the risk of breakdown and failure. The Group's documented risk policies and governance frameworks oversee these risks.

i) Special risks contracts

Loss reserve movements in the discontinued special risks portfolio are largely covered by an indemnity from Axa Winterthur.

The portfolio comprises non-standard risk schemes and there are large variations in policy coverage across the range of schemes. The wide variety of risks covered means that there is very little standardisation of terms between schemes. Administrators are required to provide updates on the activity on individual schemes through regularly submitted lists of claims settled. These provide details of claims for the period as well as exposure details such as the mix by policy term. Scheme performance is subject to actuarial review and reserves are adjusted accordingly. This involves best estimates based on the development of earning patterns by scheme and ultimate loss ratios based on available exposure information. This requires analysis of the incidence of exposure in the underlying policies throughout the policy term.

The wide variety of risks covered means that there are a significant number of uncertainties which affect the underwriting performance of the special risks portfolio arising from the economic, social and legislative environment. Reserving risk is monitored through regular reviews by external actuaries. The Group's exposure is mitigated through the indemnity from Axa Winterthur.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

3.6.4 Underwriting and pricing risk: Life insurance

The life business was closed to new business in July 2011.

For contracts where death or critical illness is the insured risk, the most significant factors that could increase the overall frequency of claims are epidemics or widespread changes in lifestyle, such as eating, smoking and exercise habits, resulting in earlier or more claims than expected.

For contracts with fixed benefits and fixed future premiums, there are no mitigating terms and conditions that reduce the insurance risk accepted.

For contracts with reviewable premiums a mitigating factor is the reviewable nature of the premium. Under the terms of the policy the retail premium can be adjusted to reflect claims experience, developments in medical technology and diagnosis and other related expenses.

The table below presents total benefits insured figures, gross and net of re-insurance.

Benefits assured for life assured business as at:

	Total benefits insured	
	Before reinsurance £ Million	After reinsurance £ Million
30 June 2012	15,428.8	1,978.5
31 December 2011	16,117.7	2,062.5
31 December 2010	17,298.0	2,214.6
31 December 2009	18,323.9	2,347.7

Uncertainty in the estimation of future benefits and premium receipts for long-term insurance contracts arises from the unpredictability of long-term changes in overall levels of mortality and morbidity, and lapse rates.

Assumptions

The Group writes only non-profit long-term business where the equity owners are entitled to 100% of the profits. The gross premium method of actuarial valuation is used. This makes explicit assumptions for interest and discount rates, mortality and morbidity, persistency and future expenses. Assumptions are reviewed annually against actual experience and industry and economic trends.

The key assumptions used for the life insurance contracts disclosed in this note are as follows:

Mortality and morbidity

The Group uses appropriate base tables of standard mortality and morbidity according to the type of contract being written and the territory in which the insured person resides. Investigations into the Group's recent experience, in conjunction with reviews of the continuous mortality and morbidity investigations performed by independent actuarial bodies, are carried out and a best estimate of the expected mortality and morbidity for the future is derived.

Investment returns

A valuation discount rate as at 30 June 2012 of 1.2% net of tax has been used (31 December 2011: 1.2%; 2010 and 2009: 2.5%).

Renewal expense level and inflation

The life business's current level of expenses, together with a margin for prudence, is taken as an appropriate expense base and an expense inflation rate as at 30 June 2012 of 5.5%

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

(31 December 2011: 5.5%; 2010 and 2009: 4.0%) is applied. This was adjusted in 2011 to allow for the inherent expense risk associated with books of business in run-off.

For regular premium creditor insurance business the Group holds a multiple of premium as the reserve. For single premium creditor insurance business the reserve is taken as a proportion of the single premium, where the proportion reflects the outstanding term remaining on the contract.

Lapses

For critical illness policies the Group has used a lapse rate as at 30 June 2012 of 4.5% per annum (31 December 2011, 2010 and 2009: 4.5%), when net cash flows are negative and a low lapse rate is prudent. Otherwise a lapse rate as at 30 June 2012 of 15.5% per annum (31 December 2011, 2010 and 2009: 15.5%) is used. For other policies, excluding over 50s polices and creditor, the Group has used a lapse rate as at 30 June 2012 of 1.5% per annum (31 December 2011, 2010 and 2009: 1.5%), when net cash flows are negative and a low lapse rate is prudent. Otherwise a lapse rate as at 30 June 2012 of 12.5% per annum (31 December 2011, 2010 and 2009: 12.5%) is used.

Change in assumptions during the period

The following estimates and assumptions used in determining assets and liabilities for life insurance contracts were changed, and had the following effect on profit recognised:

	Six months ended 30 June	Year ended 31 December		
	Effect on profit	Effect on profit		
	£ Million	£ Million	£ Million	£ Million
	2012	2011	2010	2009
Change in valuation interest rate	—	(1.4)	—	—
Mortality/Morbidity for insurance contracts	—	—	(0.4)	0.8
Expenses	—	(1.1)	(0.1)	(0.1)
Lapse rate	—	—	—	(0.5)
Total	**—**	**(2.5)**	**(0.5)**	**0.2**

There have been no changes in the estimates and assumptions used to determine the assets and liabilities for insurance contracts and therefore no effect on profit is recognised in the period.

Life insurance results are inherently uncertain, driven by actual experience being different to modelled assumptions, exacerbated by the long-term nature of the underlying exposure.

3.6.5 Reinsurance risk

The Group uses reinsurance:

- to protect the insurance results against low frequency, high severity losses through the transfer of catastrophe claims volatility to reinsurers;
- to protect the insurance results against unforeseen volumes of, or adverse trends in, large individual claims, in order to reduce volatility and to improve stability of earnings;
- to reduce the Group's capital requirements; and
- to transfer risk that is not within the Group's current risk retention strategy.

Reinsurance is essentially a swap whereby the Group will cede away insurance risk to reinsurers but in return assume back credit risk against which a reinsurance bad debt provision is assessed. The financial security of the Group's panel of reinsurers is therefore extremely important and both the quality and quantum of the assumed credit risk are subject to a credit risk approval process. The Group's leading counterparty exposures are analysed on a monthly basis where utilisation is monitored against agreed

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

individual reinsurer limits. These limits represent the accumulated credit risk for all group underwriting entities. The Group aims to contract with a diverse range of reinsurers on its contracts to mitigate the credit and/or non payment risks associated with its reinsurance exposures.

Certain of the reinsurance contracts have long durations as a result of PPOs, and insurance reserves therefore include provisions for reinsurance bad debt.

Reinsurance risk arises from:

- a failure of reinsurance to control exposure to losses, to reduce volatility or to protect capital; and/or
- an inability to place reinsurance cost effectively or on acceptable terms; and/or
- reinsurer defaults.

3.6.6 Insurance concentration risk

The Group is subject to concentration risk in a variety of forms, including:

- geographic concentration risk: the Group purchases a UK catastrophe reinsurance programme to protect against a modelled 1 in 200 year combined windstorm and coastal inundation loss. The retained deductible is £125.0 million as at 30 June 2012. There are also relevant covers to protect the Group's international businesses;
- product concentration risk: the Group's business is heavily concentrated in the UK general insurance market. However the Group offers a diversified portfolio of products and a variety of brands sold through a range of distribution channels to its customers;
- sector concentration risk: the concentration of the Group to any given industry sector is monitored and analysed in respect of commercial customers; and
- reinsurance concentration risk: reinsurance is purchased from a number of providers to ensure that a diverse range of counterparties are contracted with, within the desired credit rating range.

3.7 Financial risk

The Group is exposed to financial risk through its financial assets and financial liabilities. The Group's financial risk is concentrated within its investment portfolio and reinsurance. Further details on financial risk in respect of reinsurance can be found in note 3.6.5 on reinsurance risk.

The strategic asset allocation within the investment portfolio is agreed for each legal entity by the investment committee. The investment committee determines high level policy and controls, covering such areas as safety, liquidity and performance. They meet at least half-yearly to evaluate risk exposure, the current strategy, associated policies and investment guidelines and to consider investment recommendations submitted to it. Oversight of the implementation of decisions taken by the investment committee is via various risk fora.

The objectives set out in the investment management minimum standard are:

- to maintain the safety of the portfolio's principal both in economic terms and from an accounting and reporting perspective;
- to maintain sufficient liquidity to provide cash requirements for operations; and
- to maximise the portfolio's total return within the constraints of the other objectives and the limits defined by the investment guidelines.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

3.7.1 Market risk

Market risk encompasses any adverse movement in the value of assets as a consequence of market movements such as interest rates, credit spreads, foreign exchange rates and equity, property and inflation valuations.

The Group is exposed to market risk in both the value of its liabilities and the value of assets held. Its market risk exposure is managed in accordance with the investment strategy approved by the Board, which considers the prudence principle of asset liability management. The Group does not hold investments for trading purposes.

Governance is provided via a monthly market risk forum, which is held with the following objectives:

- to ensure that the market risk exposure is aligned with the risk appetite approved by the Board;
- to ensure adherence to the market risk policy, supporting the operating and governance frameworks, including the delegation of authorities as well as effective monitoring and reporting; and
- to provide assistance and advise the business on the management of the risk exposure.

The following tables analyse the maturity of the Group's derivative assets and liabilities as at 30 June 2012. In prior periods, the Group conducted a small amount of derivative activity, primarily in relation to hedging its investment in its foreign subsidiary in Italy. All these contracts had a maturity of three months or less.

At 30 June 2012

	Notional amounts £ Million	Less than 3 months £ Million	3 - 6 months £ Million	6 - 12 months £ Million	1 - 5 years £ Million	Over 5 years £ Million	Total fair value £ Million
Derivative assets							
At fair value through the income statement:							
Foreign exchange contracts (forwards): . .	344.6	3.6	—	—	—	—	**3.6**
Interest rate swaps:	506.7	—	—	—	—	11.5	**11.5**
Interest rate futures:	157.0	—	—	—	—	0.2	**0.2**
Designated as hedging instruments:							
Foreign exchange contracts (forwards): . .	103.2	1.8	—	—	—	—	**1.8**
Total	**1,111.5**	**5.4**	**—**	**—**	**—**	**11.7**	**17.1**

	Notional amounts £ Million	Less than 3 months £ Million	3 - 6 months £ Million	6 - 12 months £ Million	1 - 5 years £ Million	Over 5 years £ Million	Total fair value £ Million
Derivative liabilities							
At fair value through the income statement:							
Foreign exchange contracts (forwards): . .	34.1	—	—	—	—	—	**—**
Interest rate swaps:	171.8	—	—	—	0.3	0.1	**0.4**
Designated as hedging instruments:							
Foreign exchange contracts (forwards): . .	186.3	0.8	0.3	0.1	—	—	**1.2**
Total	**392.2**	**0.8**	**0.3**	**0.1**	**0.3**	**0.1**	**1.6**

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

The Group assesses its market risk exposure through value at risk measures, sensitivity measures and stress testing within its business as usual. These tests are designed to consider the impact on capital arising from 'severe but plausible' scenarios.

Interest rate risk

Interest rate risk arises from the asset liability mismatch exposure to the fluctuation of the interest rate. On the asset side the interest rate risk exposure arises from the Group's investment in fixed income securities. On the liabilities side, the Group's exposure arises from the PPOs and subordinated liabilities.

As at 30 June 2012, £401.4 million of the UK investment portfolio is invested in US dollar corporates via two US dollar fund managers, and these facilities were entered into during May 2012. When interest rates rise, the market value of the bond holdings falls. This is not off set by a fall in fixed interest rate liabilities. To neutralise the interest rate exposure on the US dollar portfolio, the Group uses a series of 'fixed into floating' interest rate swaps which change value in response to the rate changes in a direction opposite to bonds thereby providing a hedge.

Spread risk

Spread risk results from the sensitivity of the value of assets, liabilities and financial instruments to changes in the level or in the volatility of credit spreads over the risk-free interest rate term structure.

The main exposure to spread risk is generated by the investment portfolio.

Currency risk

The UK portfolio had exposure to foreign currency (US dollar and euros) as a result of an investment in a managed fund which was hedged back to sterling. The value of this holding as at 30 June 2012 was £nil (31 December 2011: £382.8 million; 2010; £370.9 million; 2009: £367.3 million).

The proportion of the UK portfolio that is invested in US dollars, is managed through the appointment of two US dollar fund managers, and funds are invested in accordance with the investment management agreement. The exposure is hedged back to sterling using a series of forward foreign exchange contracts. The value of this holding as at 30 June 2012 was £401.4 million (31 December 2011, 2010 and 2009: £nil).

Other foreign currency exposure such as outsourced supply services, international motor insurance cover or travel insurance cover policies have a lower level of materiality. The majority of the insurance business is underwritten in local currency, in sterling for the UK subsidiaries and in euros for the German and Italian subsidiaries.

For claims and premium reserves there is very little foreign exchange risk as the majority of claims are denominated in the domiciled currency of operation of the Group's companies except some foreign travel risks (motor and travel policies).

With the exception of the dollar mandate, which commenced in May 2012, and allows part of the UK investment portfolio to be invested in US dollars and the International business based in Germany and Italy (euro assets and liabilities), predominantly all other financial assets and liabilities are denominated in sterling and do not bear any exposure to currency risk.

As at June 2012, £1.4 million in cash has been pledged by the Group as collateral with regards to facilitating derivative trading (both interest rate and foreign exchange). The terms and conditions of collateral pledged for both assets and liabilities are market standard.

Property price risk

The Group is exposed to property price risk from the properties which form part of its own premises. As at 30 June 2012, all the properties are based in the UK and belong to the main UK subsidiary and are subject to the asset admissibility rules laid down by the FSA.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

Under the new investment strategy, the main UK subsidiary is reallocating a maximum of 5% of its portfolio into real estate over a period of around eighteen months, which commenced in August 2012. The risk exposure of these investments will be monitored through the value at risk measure.

Equity risk

The Group holds no equities within its investment portfolios.

Sensitivity analysis

Some results of sensitivity testing are set out below. For each sensitivity test the impact of a reasonably possible change in a single factor is shown, with other assumptions left unchanged.

Sensitivity factor	Description of sensitivity analysis
Market prices	The impact of a change in market prices on financial investments by +/− 10%.
Interest rate and investment return	The impact of a change in market interest rates by +/− 1% (e.g. if a current interest rate is 2%, the impact of an immediate change to 1% or 3%).
Periodical payment order liabilities	The impact of a change in the rate of interest used for the calculation of present values is assumed to change by +/− 1%.
Investment funds and property market values	The impact of a change in other investment funds and property market values by +/− 15%.

Sensitivity at 30 June 2012

Increase / (decrease) in income statement before tax (£ Million)

	Market prices		Interest rate and investment return		Periodical payment order liabilities		Investment funds and property market values	
	+10%	−10%	+1%	−1%	+1%	−1%	+15%	−15%
Gross of reinsurance	—	—	7.9	(7.9)	190.2	(271.5)	—	—
Net of reinsurance	—	—	7.9	(7.9)	105.4	(148.1)	—	—

Impact before tax on total equity (£ Million)

	Market prices		Interest rate and investment return		Periodical payment order liabilities		Investment funds and property market values	
	+10%	−10%	+1%	−1%	+1%	−1%	+15%	−15%
Gross of reinsurance	703.3	(703.3)	(179.4)	179.4	190.2	(271.5)	—	—
Net of reinsurance	703.3	(703.3)	(179.4)	179.4	105.4	(148.1)	—	—

In April 2012, the Group acquired Direct Line Versicherung AG, and the net asset values of both international subsidiaries were hedged from this date.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

Sensitivity at 31 December 2011

Increase / (decrease) in income statement before tax (£ Million)

	Market prices		Interest rate and investment return		Periodical payment order liabilities		Investment funds and property market values	
	+10%	−10%	+1%	−1%	+1%	−1%	+15%	−15%
Gross of reinsurance	—	—	9.2	(9.2)	174.9	(252.2)	10.4	(10.4)
Net of reinsurance	—	—	9.2	(9.2)	106.5	(152.1)	10.4	(10.4)

Impact before tax on total equity (£ Million)

	Market prices		Interest rate and investment return		Periodical payment order liabilities		Investment funds and property market values	
	+10%	−10%	+1%	−1%	+1%	−1%	+15%	−15%
Gross of reinsurance	760.8	(760.8)	(233.2)	233.2	174.9	(252.2)	67.8	(67.8)
Net of reinsurance	760.8	(760.8)	(233.2)	233.2	106.5	(152.1)	67.8	(67.8)

Sensitivity at 31 December 2010

Increase / (decrease) in income statement before tax (£ Million)

	Market prices		Interest rate and investment return		Periodical payment order liabilities		Investment funds and property market values	
	+10%	−10%	+1%	−1%	+1%	−1%	+15%	−15%
Gross of reinsurance	—	—	12.7	(13.0)	160.9	(234.8)	12.5	(12.5)
Net of reinsurance	—	—	12.7	(13.0)	101.4	(143.8)	12.5	(12.5)

Impact before tax on total equity (£ Million)

	Market prices		Interest rate and investment return		Periodical payment order liabilities		Investment funds and property market values	
	+10%	−10%	+1%	−1%	+1%	−1%	+15%	−15%
Gross of reinsurance	749.6	(749.6)	(159.1)	158.9	160.9	(234.8)	68.2	(68.2)
Net of reinsurance	749.6	(749.6)	(159.1)	158.9	101.4	(143.8)	68.2	(68.2)

Sensitivity at 31 December 2009

Increase / (decrease) in income statement before tax (£ Million)

	Market prices		Interest rate and investment return		Periodical payment order liabilities		Investment funds and property market values	
	+10%	−10%	+1%	−1%	+1%	−1%	+15%	−15%
Gross of reinsurance	—	—	22.4	(22.9)	N/A*	N/A*	11.7	(11.7)
Net of reinsurance	—	—	22.4	(22.9)	N/A*	N/A*	11.7	(11.7)

Impact before tax on total equity (£ Million)

	Market prices		Interest rate and investment return		Periodical payment order liabilities		Investment funds and property market values	
	+10%	−10%	+1%	−1%	+1%	−1%	+15%	−15%
Gross of reinsurance	698.0	(698.0)	(207.7)	232.4	N/A*	N/A*	66.8	(66.8)
Net of reinsurance	698.0	(698.0)	(207.7)	232.4	N/A*	N/A*	66.8	(66.8)

* The sensitivity analysis data for periodical payment order liabilities in 2009 is not available.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

Limitations of sensitivity analysis

The above tables show the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

3.7.2 Credit risk

Credit risk arises from the potential that losses are incurred from the failure of a counterparty to meet its credit obligations, either due to their failure and/or their inability to pay, or their unwillingness to pay amounts due.

The objective of the credit risk policy and supporting minimum standards is to document the control processes by which the Group is able to identify, monitor, measure, manage, control and mitigate the level of credit risk to which it is exposed effectively. The credit risk control environment is summarised below:

Credit risk and investment forum

The primary responsibility of this forum is to ensure that all material aspects of credit risk within the Group are identified, monitored and measured.

Credit risk sanctioning committee

The primary responsibility of this committee is to approve new and increased credit risk limits in excess of business area credit authorities but within the committee's credit authority.

Monitoring and reporting

Relevant business units monitor the level of their actual credit exposure and measure this against approved credit terms and limits.

The main sources of credit risk for the Group are as follows:

- Investment counterparty–this arises from the investment of monies in the range of investment vehicles permitted by the investment policy.
- Reinsurance recoveries–credit exposure to reinsurance counterparties arises in respect of reinsurance claims against which a reinsurance bad debt provision is assessed. The Courts Act 2003, implemented in April 2005, gave the Courts the power to award PPOs in place of lump sum awards to cover the future costs element of claims (i.e. loss of future earnings and/or cost of future care). PPOs have the potential to increase the ultimate value of a claim and by their very nature, significantly increase the length of time to reach final payment. Consequently any assumed (reinsurance) credit risk is both in terms of quantum and longevity with any increasing exposure to PPOs.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

The following table provides information regarding the carrying value of financial and insurance assets that are neither past due nor impaired, the ageing of financial assets that are past due but not impaired and financial assets that have been impaired.

At 30 June 2012

	Neither past due nor impaired £ Million	Past due 1 - 30 days £ Million	Past due 31 - 60 days £ Million	Past due 61 - 90 days £ Million	Past due more than 91 days £ Million	Financial assets that have been impaired £ Million	Carrying value in the balance sheet £ Million
Debt securities (note 24)	7,023.7	—	—	—	—	9.1	**7,032.8**
Deposits with credit institutions (note 24 & 25)	2,775.5	—	—	—	—	—	**2,775.5**
Insurance liabilities–reinsurance asset (note 20)	964.1	0.1	—	—	—	—	**964.2**
Derivative assets (note 23)	17.1	—	—	—	—	—	**17.1**
Cash at bank and in hand (note 25)	273.1	—	—	—	—	—	**273.1**
Insurance and other loans and receivables (note 22)	1,181.4	34.3	5.7	5.1	7.3	—	**1,233.8**
Total assets bearing credit risk	**12,234.9**	**34.4**	**5.7**	**5.1**	**7.3**	**9.1**	**12,296.5**

At 31 December 2011

	Neither past due nor impaired £ Million	Past due 1 - 30 days £ Million	Past due 31 - 60 days £ Million	Past due 61 - 90 days £ Million	Past due more than 91 days £ Million	Financial assets that have been impaired £ Million	Carrying value in the balance sheet £ Million
Debt securities (note 24)	7,598.3	—	—	—	0.7	8.9	**7,607.9**
Deposits with credit institutions (note 24 & 25)	3,050.3	—	—	—	—	—	**3,050.3**
Insurance liabilities–reinsurance asset (note 20)	741.6	—	—	—	—	—	**741.6**
Derivative assets (note 23)	0.1	—	—	—	—	—	**0.1**
Cash at bank and in hand (note 25)	201.9	—	—	—	—	—	**201.9**
Insurance and other loans and receivables (note 22)	1,223.1	22.4	3.5	2.1	1.8	—	**1,252.9**
Total assets bearing credit risk	**12,815.3**	**22.4**	**3.5**	**2.1**	**2.5**	**8.9**	**12,854.7**

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

At 31 December 2010

	Neither past due nor impaired £ Million	Past due 1 - 30 days £ Million	Past due 31 - 60 days £ Million	Past due 61 - 90 days £ Million	Past due more than 91 days £ Million	Financial assets that have been impaired £ Million	Carrying value in the balance sheet £ Million
Debt securities (note 24)	7,488.1	—	—	—	—	8.1	**7,496.2**
Deposits with credit institutions (note 24 & 25)	2,941.4	—	—	—	—	—	**2,941.4**
Insurance liabilities–reinsurance asset (note 20)	660.9	—	—	—	—	—	**660.9**
Derivative assets (note 23)	—	—	—	—	—	—	**—**
Cash at bank and in hand (note 25)	234.3	—	—	—	—	—	**234.3**
Insurance and other loans and receivables (note 22)	1,551.8	32.4	4.8	3.7	13.5	—	**1,606.2**
Total assets bearing credit risk	**12,876.5**	**32.4**	**4.8**	**3.7**	**13.5**	**8.1**	**12,939.0**

At 31 December 2009

	Neither past due nor impaired £ Million	Past due 1 - 30 days £ Million	Past due 31 - 60 days £ Million	Past due 61 - 90 days £ Million	Past due more than 91 days £ Million	Financial assets that have been impaired £ Million	Carrying value in the balance sheet £ Million
Debt securities (note 24)	6,979.3	—	—	—	—	—	**6,979.3**
Deposits with credit institutions (note 24 & 25)	2,905.4	—	—	—	—	—	**2,905.4**
Insurance liabilities–reinsurance asset (note 20)	517.6	—	—	—	—	—	**517.6**
Derivative assets (note 23)	1.3	—	—	—	—	—	**1.3**
Cash at bank and in hand (note 25)	123.5	—	—	—	—	—	**123.5**
Insurance and other loans and receivables (note 22)	1,671.5	46.3	6.1	4.1	4.8	—	**1,732.8**
Total assets bearing credit risk	**12,198.6**	**46.3**	**6.1**	**4.1**	**4.8**	**—**	**12,259.9**

The Group does not hold any collateral as security. There were no material financial assets that would have been past due or impaired had the terms not been renegotiated.

The following table analyses the credit quality of debt securities (note 24) that are neither past due nor impaired by type of asset.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

At 30 June 2012

	AFS—Sovereign and Local government debt securities £ Million	AFS—Corporate debt securities £ Million	AFS—Banks debt securities £ Million	AFS—Other Financial Institutions debt securities £ Million	Total AFS debt securities £ Million	AFS—Mortgage Backed Securities £ Million	AFS—Non MBS debt securities £ Million
AAA rated	2,856.6	145.7	534.5	26.5	**3,563.3**	165.9	3,397.4
AA and above	90.5	283.3	352.6	—	**726.4**	—	726.4
A and above	—	1,502.8	702.0	23.4	**2,228.2**	—	2,228.2
BBB− and above	—	400.0	80.1	4.7	**484.8**	3.4	481.4
BB+ and below	—	—	30.1	—	**30.1**	—	30.1
Total by debt security type	**2,947.1**	**2,331.8**	**1,699.3**	**54.6**	**7,032.8**	**169.3**	**6,863.5**

At 31 December 2011

	AFS—Sovereign and Local government debt securities £ Million	AFS—Corporate debt securities £ Million	AFS—Banks debt securities £ Million	AFS—Other Financial Institutions debt securities £ Million	Total AFS debt securities £ Million	AFS—Mortgage Backed Securities £ Million	AFS—Non MBS debt securities £ Million
AAA rated	3,415.0	96.4	637.0	27.3	**4,175.7**	206.8	3,968.9
AA and above	57.0	279.9	434.0	—	**770.9**	67.2	703.7
A and above	9.2	1,377.3	858.1	11.3	**2,255.9**	9.5	2,246.4
BBB− and above	—	287.7	82.4	4.7	**374.8**	—	374.8
BB+ and below	—	—	23.3	—	**23.3**	—	23.3
Unrated	—	—	7.3	—	**7.3**	—	7.3
Total by debt security type	**3,481.2**	**2,041.3**	**2,042.1**	**43.3**	**7,607.9**	**283.5**	**7,324.4**

At 31 December 2010

	AFS—Sovereign and Local government debt securities £ Million	AFS—Corporate debt securities £ Million	AFS—Banks debt securities £ Million	AFS—Other Financial Institutions debt securities £ Million	Total AFS debt securities £ Million	AFS—Mortgage Backed Securities £ Million	AFS—Non MBS debt securities £ Million
AAA rated	3,011.4	62.9	1,148.2	—	**4,222.5**	476.3	3,746.2
AA and above	15.8	227.3	855.6	24.2	**1,122.9**	9.3	1,113.6
A and above	4.3	855.4	1,053.9	11.3	**1,924.9**	10.5	1,914.4
BBB− and above	—	107.6	95.8	9.3	**212.7**	—	212.7
BB+ and below	—	—	11.9	—	**11.9**	—	11.9
Unrated	—	—	1.3	—	**1.3**	—	1.3
Total by debt security type	**3,031.5**	**1,253.2**	**3,166.7**	**44.8**	**7,496.2**	**496.1**	**7,000.1**

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

At 31 December 2009

	AFS—Sovereign and Local government debt securities £ Million	AFS—Corporate debt securities £ Million	AFS—Banks debt securities £ Million	AFS—Other Financial Institutions debt securities £ Million	Total AFS debt securities £ Million	AFS—Mortgage Backed Securities £ Million	AFS—Non MBS debt securities £ Million
AAA rated	1,644.6	86.0	1,579.0	—	**3,309.6**	667.4	2,642.2
AA and above	41.4	337.0	1,331.0	23.2	**1,732.6**	3.7	1,728.9
A and above	—	648.0	1,123.7	—	**1,771.7**	15.2	1,756.5
BBB− and above	—	—	81.0	—	**81.0**	—	81.0
BB+ and below	—	—	49.3	—	**49.3**	—	49.3
Unrated	—	—	35.1	—	**35.1**	—	35.1
Total by debt security type	**1,686.0**	**1,071.0**	**4,199.1**	**23.2**	**6,979.3**	**686.3**	**6,293.0**

Bank debt securities can be further analysed as Secured as at 30 June £297.5 million (31 December 2011: £418.8 million; 2010: £568.7 million; 2009: £770.9 million), Unsecured £1,228.7 million (31 December 2011: £1,357.1 million; 2010: £2,362.6 million; 2009: £2,979.3 million), Subordinated £173.1 million (31 December 2011: £193.9 million; 2010: £235.4 million; 2009: £448.9 million) and Certificates of Deposit £nil (31 December 2011: £72.3 million; 2010: £nil; 2009: £nil).

The following table analyses the credit quality of financial and insurance assets that are neither past due nor impaired by type of asset, excluding debt securities. The table includes reinsurance exposure, after provision. Note 3.6.5 details the Group's approach to reinsurance credit risk management.

At 30 June 2012

	AAA £ Million	AA+ to AA− £ Million	A+ to A− £ Million	BBB £ Million	Not rated £ Million	Total £ Million
Deposits with credit institutions (note 24 & 25)	1,128.4	450.7	1,151.4	45.0	—	**2,775.5**
Insurance liabilities–reinsurance asset (note 20)	8.2	569.8	343.0	5.1	38.1	**964.2**
Derivative assets (note 23)	—	—	16.9	—	0.2	**17.1**
Cash at bank and in hand (note 25)	—	63.9	197.5	11.0	0.7	**273.1**
Insurance and other loans and receivables (note 22)	19.2	6.1	117.5	—	1,091.0	**1,233.8**
Total	**1,155.8**	**1,090.5**	**1,826.3**	**61.1**	**1,130.0**	**5,263.7**

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

At 31 December 2011

	AAA £ Million	AA+ to AA− £ Million	A+ to A− £ Million	BBB £ Million	Not rated £ Million	Total £ Million
Deposits with credit institutions (note 24 & 25)	637.1	398.0	1,622.4	10.0	—	**2,667.5**
Insurance liabilities–reinsurance asset (note 20)	32.4	484.9	177.4	5.9	41.0	**741.6**
Derivative assets (note 23)	—	—	0.1	—	—	**0.1**
Cash at bank and in hand (note 25)	—	—	201.9	—	—	**201.9**
Insurance and other loans and receivables (note 22)	1.2	23.7	143.9	—	1,084.1	**1,252.9**
Total	**670.7**	**906.6**	**2,145.7**	**15.9**	**1,125.1**	**4,864.0**

At 31 December 2010

	AAA £ Million	AA+ to AA− £ Million	A+ to A− £ Million	BBB £ Million	Not rated £ Million	Total £ Million
Deposits with credit institutions (note 24 & 25)	631.3	1,220.3	718.9	—	—	**2,570.5**
Insurance liabilities–reinsurance asset (note 20)	28.9	359.2	256.3	—	16.5	**660.9**
Derivative assets (note 23)	—	—	—	—	—	**—**
Cash at bank and in hand (note 25)	—	—	234.2	—	0.1	**234.3**
Insurance and other loans and receivables (note 22)	2.3	28.2	220.3	—	1,355.4	**1,606.2**
Total	**662.5**	**1,607.7**	**1,429.7**	**—**	**1,372.0**	**5,071.9**

At 31 December 2009

	AAA £ Million	AA+ to AA− £ Million	A+ to A− £ Million	BBB £ Million	Not rated £ Million	Total £ Million
Deposits with credit institutions (note 24 & 25)	604.7	511.8	1,421.6	—	—	**2,538.1**
Insurance liabilities–reinsurance asset (note 20)	25.5	264.9	203.4	—	23.8	**517.6**
Derivative assets (note 23)	—	—	1.3	—	—	**1.3**
Cash at bank and in hand (note 25)	—	0.1	123.3	—	0.1	**123.5**
Insurance and other loans and receivables (note 22)	1.6	26.4	113.1	1.6	1,590.1	**1,732.8**
Total	**631.8**	**803.2**	**1,862.7**	**1.6**	**1,614.0**	**4,913.3**

Investments in other investment funds as at 30 June 2012 were £nil (31 December 2011: £382.8 million; 2010: £370.9 million; 2009: £367.3 million). These were not included in the "Deposits with credit institutions" above, as the disclosure of the funds held by credit quality is considered to be impractical.

Other loans and receivables due from policyholders, agents, brokers and intermediaries generally do not have a credit rating.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

3.7.3 Liquidity risk

Liquidity risk is the potential that obligations cannot be met as they fall due as a consequence of having a timing mismatch and/or an inability to raise sufficient liquid assets/cash without suffering a substantial loss on realisation.

The measurement and management of liquidity risk within the Group is undertaken within the limits and other policy parameters of the Group's liquidity risk appetite. Compliance is monitored both in respect of the internal policy and the regulatory requirements of local regulators.

In the event that one or more liquidity stresses or scenarios crystallises, or should any other event that may impact liquidity occur, the Group seeks to ensure that the event has a rapid and controlled response. In such an event, a liquidity crisis management team will be formed to assess the nature and extent of the threat and to develop an appropriate response.

Analysis of maturity of debt securities

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Within 1 year	800.0	818.8	1,876.1	1,230.4
1 - 3 years	2,814.0	2,808.3	1,753.7	2,428.5
3 - 5 years	1,843.8	2,140.0	2,109.7	1,325.9
5 - 10 years	1,419.6	1,576.4	1,256.4	1,321.2
Over 10 years	155.4	264.4	500.3	673.3
Total	**7,032.8**	**7,607.9**	**7,496.2**	**6,979.3**

In addition to the above, the Group held cash and cash equivalents, as at 30 June 2012 of £2,565.6 million (31 December 2011: £1,379.8 million; 2010: £1,841.4 million; 2009: £1,260.3 million) to cover short-term liabilities arising from insurance contracts.

Analysis of maturity of liabilities

For each category of insurance and financial liabilities, the following table shows the gross liability analysed by remaining duration. The total liability is split by remaining duration in proportion to the cash-flows expected to arise during that period.

At 30 June 2012

	Total £ Million	Within 1 year £ Million	1 - 3 years £ Million	3 - 5 years £ Million	5 - 10 years £ Million	Over 10 years £ Million
Subordinated liabilities (note 29)	**516.1**	8.2	—	—	507.9	—
Insurance liabilities (note 30)	**6,514.6**	1,964.5	1,748.3	872.7	891.8	1,037.3
Borrowings (note 32)	**83.7**	83.7	—	—	—	—
Trade and other payables including insurance payables (note 34)	**737.2**	735.4	1.7	0.1	—	—
Total	**7,851.6**	**2,791.8**	**1,750.0**	**872.8**	**1,399.7**	**1,037.3**

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

At 31 December 2011

	Total £ Million	Within 1 year £ Million	1 - 3 years £ Million	3 - 5 years £ Million	5 - 10 years £ Million	Over 10 years £ Million
Insurance liabilities (note 30)	**6,509.0**	2,054.8	1,844.4	864.6	850.3	894.9
Borrowings (note 32)	**317.9**	71.5	205.0	—	11.3	30.1
Trade and other payables including insurance payables (note 34)	**910.2**	910.2	—	—	—	—
Total	**7,737.1**	**3,036.5**	**2,049.4**	**864.6**	**861.6**	**925.0**

At 31 December 2010

	Total £ Million	Within 1 year £ Million	1 - 3 years £ Million	3 - 5 years £ Million	5 - 10 years £ Million	Over 10 years £ Million
Insurance liabilities (note 30)	**6,941.4**	2,400.0	2,001.7	939.2	680.3	920.2
Borrowings (note 32)	**327.1**	296.0	—	—	—	31.1
Trade and other payables including insurance payables (note 34)	**698.0**	698.0	—	—	—	—
Total	**7,966.5**	**3,394.0**	**2,001.7**	**939.2**	**680.3**	**951.3**

At 31 December 2009

	Total £ Million	Within 1 year £ Million	1 - 3 years £ Million	3 - 5 years £ Million	5 - 10 years £ Million	Over 10 years £ Million
Insurance liabilities (note 30)	**5,928.5**	2,190.5	1,937.7	947.2	659.1	194.0
Borrowings (note 32)	**285.2**	253.2	—	—	—	32.0
Trade and other payables including insurance payables (note 34)	**801.0**	801.0	—	—	—	—
Total	**7,014.7**	**3,244.7**	**1,937.7**	**947.2**	**659.1**	**226.0**

The above tables exclude unearned premium reserves as there are no liquidity risks inherent in them.

3.7.4 Investment concentration risk

Investment concentration risk arises through excessive exposure to particular industry sectors, groups of business undertakings or similar activities. The Group may suffer significant losses in its investment portfolio as a result of over exposure to particular sectors engaged in similar activities or similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

The distribution of the debt securities held by geographical area as at 30 June 2012, was as follows:

	AFS— Sovereign and local government debt securities £ Million	AFS— Corporate debt securities £ Million	AFS— Banks debt securities £ Million	AFS— Other Financial Institutions debt securities £ Million	Total AFS debt securities £ Million	AFS— Mortgage Backed Securities £ Million	AFS— Non MBS debt securities £ Million
Australia	—	56.8	152.6	38.1	**247.5**	—	247.5
Austria	2.8	—	—	—	**2.8**	—	2.8
Belgium	6.9	7.8	—	—	**14.7**	—	14.7
Canada	110.1	16.1	2.0	—	**128.2**	—	128.2
Denmark	—	14.7	23.9	—	**38.6**	—	38.6
Finland	—	3.5	5.8	—	**9.3**	—	9.3
France	59.9	234.9	93.9	—	**388.7**	8.2	380.5
Germany	—	199.8	239.1	—	**438.9**	44.6	394.3
Hong Kong	—	3.3	—	—	**3.3**	—	3.3
Ireland	—	4.6	23.3	—	**27.9**	3.4	24.5
Israel	—	2.0	—	—	**2.0**	—	2.0
Italy	—	13.4	—	—	**13.4**	—	13.4
Japan	—	30.5	—	—	**30.5**	—	30.5
Mexico	—	10.4	—	—	**10.4**	—	10.4
Netherlands	4.3	39.1	79.9	—	**123.3**	—	123.3
New Zealand	—	26.2	9.8	—	**36.0**	—	36.0
Norway	66.4	2.0	7.4	—	**75.8**	—	75.8
Singapore	—	24.3	—	—	**24.3**	—	24.3
Spain	—	—	9.9	—	**9.9**	—	9.9
Sweden	20.3	29.2	141.7	—	**191.2**	—	191.2
Switzerland	—	56.0	40.7	—	**96.7**	—	96.7
UK	2,175.9	1,129.7	732.1	4.7	**4,042.4**	113.1	3,929.3
United Arab Emirates	—	3.3	—	—	**3.3**	—	3.3
USA	—	424.2	137.2	11.8	**573.2**	—	573.2
Multilateral / Supranational	500.5	—	—	—	**500.5**	—	500.5
Total	**2,947.1**	**2,331.8**	**1,699.3**	**54.6**	**7,032.8**	**169.3**	**6,863.5**

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

The distribution of the debt securities held by geographical area as at 31 December in 2011, was as follows:

	AFS— Sovereign and local government debt securities £ Million	AFS— Corporate debt securities £ Million	AFS— Banks debt securities £ Million	AFS— Other Financial Institutions debt securities £ Million	Total AFS debt securities £ Million	AFS— Mortgage Backed Securities £ Million	AFS— Non MBS debt securities £ Million
Australia	—	74.6	164.9	38.3	**277.8**	—	277.8
Austria	2.8	—	10.0	—	**12.8**	—	12.8
Belgium	6.9	2.7	4.4	—	**14.0**	—	14.0
Canada	68.1	16.6	1.8	—	**86.5**	—	86.5
Cayman Islands	—	2.8	—	—	**2.8**	—	2.8
Denmark	—	8.4	23.0	—	**31.4**	—	31.4
Finland	—	3.6	4.3	—	**7.9**	—	7.9
France	77.4	249.3	108.5	—	**435.2**	9.7	425.5
Germany	—	108.7	275.7	—	**384.4**	29.0	355.4
Ireland	—	13.4	28.9	—	**42.3**	3.7	38.6
Italy	—	13.8	—	—	**13.8**	—	13.8
Japan	—	16.3	—	—	**16.3**	—	16.3
Luxembourg	—	5.2	—	—	**5.2**	—	5.2
Mexico	—	7.5	—	—	**7.5**	—	7.5
Netherlands	4.4	183.9	111.1	—	**299.4**	—	299.4
New Zealand	—	18.0	8.5	—	**26.5**	—	26.5
Norway	43.0	—	18.1	—	**61.1**	—	61.1
Spain	—	8.7	16.0	—	**24.7**	—	24.7
Sweden	9.2	25.6	123.7	—	**158.5**	—	158.5
Switzerland	—	7.1	36.8	—	**43.9**	—	43.9
UK	2,780.8	1,144.2	921.0	5.0	**4,851.0**	241.1	4,609.9
United Arab Emirates	—	2.6	0.4	—	**3.0**	—	3.0
USA	—	128.3	185.0	—	**313.3**	—	313.3
Multilateral / Supranational	488.6	—	—	—	**488.6**	—	488.6
Total	**3,481.2**	**2,041.3**	**2,042.1**	**43.3**	**7,607.9**	**283.5**	**7,324.4**

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

The distribution of the debt securities held by geographical area as at 31 December 2010, was as follows:

	AFS— Sovereign and local government debt securities £ Million	AFS— Corporate debt securities £ Million	AFS— Banks debt securities £ Million	AFS— Other Financial Institutions debt securities £ Million	Total AFS debt securities £ Million	AFS— Mortgage Backed Securities £ Million	AFS— Non MBS debt securities £ Million
Australia	—	32.0	267.5	35.5	**335.0**	—	335.0
Austria	2.8	—	9.8	—	**12.6**	—	12.6
Belgium	7.0	0.9	4.6	—	**12.5**	—	12.5
Canada	21.5	15.9	57.0	—	**94.4**	—	94.4
Denmark	—	—	84.9	—	**84.9**	—	84.9
Finland	—	—	4.4	—	**4.4**	—	4.4
France	—	133.4	170.3	—	**303.7**	10.1	293.6
Germany	—	98.1	245.1	9.3	**352.5**	40.2	312.3
Ireland	4.3	119.5	26.9	—	**150.7**	3.6	147.1
Italy	8.7	14.5	9.6	—	**32.8**	—	32.8
Japan	—	2.2	—	—	**2.2**	—	2.2
Luxembourg	—	5.1	—	—	**5.1**	—	5.1
Netherlands	4.5	136.6	136.4	—	**277.5**	—	277.5
New Zealand	—	17.7	14.4	—	**32.1**	—	32.1
Norway	—	—	0.8	—	**0.8**	—	0.8
Spain	—	—	120.3	—	**120.3**	—	120.3
Sweden	—	14.5	107.4	—	**121.9**	—	121.9
Switzerland	—	7.3	33.1	—	**40.4**	—	40.4
UK	2,728.8	590.1	1,574.0	—	**4,892.9**	442.2	4,450.7
United Arab Emirates	—	—	0.8	—	**0.8**	—	0.8
USA	—	65.4	299.4	—	**364.8**	—	364.8
Multilateral / Supranational	253.9	—	—	—	**253.9**	—	253.9
Total	**3,031.5**	**1,253.2**	**3,166.7**	**44.8**	**7,496.2**	**496.1**	**7,000.1**

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

The distribution of the debt securities held by geographical area as at 31 December 2009, was as follows:

	AFS— Sovereign and local government debt securities £ Million	AFS— Corporate debt securities £ Million	AFS— Banks debt securities £ Million	AFS— Other Financial Institutions debt securities £ Million	Total AFS debt securities £ Million	AFS— Mortgage Backed Securities £ Million	AFS— Non MBS debt securities £ Million
Australia	—	22.1	329.3	23.2	**374.6**	—	374.6
Austria	—	—	9.7	—	**9.7**	—	9.7
Belgium	2.8	11.1	13.9	—	**27.8**	9.2	18.6
Canada	21.2	16.2	88.1	—	**125.5**	—	125.5
Cayman Islands	—	—	7.1	—	**7.1**	—	7.1
Denmark	—	—	63.5	—	**63.5**	—	63.5
Finland	—	—	—	—	**—**	—	—
France	9.0	27.5	236.9	—	**273.4**	8.8	264.6
Germany	—	41.8	287.9	—	**329.7**	32.4	297.3
Ireland	4.6	120.5	66.9	—	**192.0**	3.6	188.4
Italy	4.6	2.6	60.5	—	**67.7**	—	67.7
Japan	—	—	—	—	**—**	—	—
Luxembourg	—	5.1	—	—	**5.1**	—	5.1
Netherlands	4.5	116.0	172.0	—	**292.5**	—	292.5
New Zealand	—	8.4	24.6	—	**33.0**	—	33.0
Norway	32.6	—	6.0	—	**38.6**	—	38.6
Spain	29.4	—	260.3	—	**289.7**	—	289.7
Sweden	—	10.4	83.9	—	**94.3**	4.5	89.8
Switzerland	—	—	27.7	—	**27.7**	—	27.7
UK	1,212.9	611.7	2,074.7	—	**3,899.3**	627.8	3,271.5
United Arab Emirates	—	—	1.5	—	**1.5**	—	1.5
USA	—	77.6	384.6	—	**462.2**	—	462.2
Multilateral / Supranational	364.4	—	—	—	**364.4**	—	364.4
Total	**1,686.0**	**1,071.0**	**4,199.1**	**23.2**	**6,979.3**	**686.3**	**6,293.0**

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

The distribution of the debt securities held across industry sectors using Bloomberg classifications was as follows:

	30 June		31 December					
	2012		2011		2010		2009	
	£ Million		£ Million		£ Million		£ Million	
Asset backed securities	—	—	—	—	—	—	42.6	1%
Basic Materials	123.3	2%	117.9	2%	70.0	1%	49.3	1%
Communications	242.4	3%	196.7	3%	57.0	1%	22.1	0%
Consumer, Cyclical	92.4	1%	56.1	1%	33.2	0%	26.8	0%
Consumer, Non-cyclical	375.7	5%	291.4	4%	135.9	2%	75.8	1%
Diversified	111.1	2%	148.5	2%	63.9	1%	41.3	1%
Energy	255.7	4%	210.2	3%	116.7	2%	164.1	2%
Financial	1,822.8	26%	1,917.4	25%	2,841.4	38%	3,692.8	53%
Government	2,947.1	42%	3,481.2	44%	3,031.5	40%	1,686.0	24%
Industrial	141.6	2%	100.9	1%	34.4	0%	1.4	0%
Mortgage Backed Securities	169.3	3%	283.5	4%	496.1	7%	686.3	10%
Technology	21.6	0%	—	—	—	—	4.4	0%
Transport	18.0	0%	—	—	—	—	—	—
Utilities	711.8	10%	804.1	11%	616.1	8%	486.4	7%
Total	**7,032.8**	**100%**	**7,607.9**	**100%**	**7,496.2**	**100%**	**6,979.3**	**100%**

There were no investments in other investment funds as at 30 June 2012 (31 December 2011: £382.8 million; 2010: £370.9 million; 2009: £367.3 million). These were not analysed in the above for prior periods, as the disclosure of the funds held by industry sector is considered to be impractical.

3.8 Operational risk

Effective operational risk management requires the Group to identify, assess, manage, monitor, report and mitigate all areas of exposure. Operational risk is inherent in all of the Group's business processes, systems and products, and from external events, with the Group's ERM framework detailing the minimum standards, tools, techniques and other processes used to ensure that operational risks are identified, managed and mitigated to an acceptable level and that contingency plans are in place.

There are a number of key factors that cause operational risk across the Group, such as:

- the Group's operations support complex transactions and are highly dependent on the proper functioning of its IT and communication systems;
- a dependency on the use of third party information technology, software, data and service providers;
- a need to adequately maintain and protect customer and employee information; and
- the ability of the Group to attract and retain key qualified personnel.

Effective operational risk management helps the Group to achieve its objectives, including:

- more focus on doing things the right way, leading to fewer surprises;
- fewer operational errors and losses, leading to increased customer satisfaction and higher quality earnings;
- better informed risk-taking, which creates greater rewards;
- increased management attention on the risks and issues that really matter; and
- lower risk-based capital due to lower expected losses.

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

3.9 Emerging risk

There are a range of regulatory and legal changes which may impact the Group's reserves, pricing or financial condition in future years in relation to business already written. These include:

- on 14 December 2011, the Office of Fair Trading launched a market study into private motor insurance, with a focus on the provision of third party vehicle repairs and credit hire replacement vehicles to claimants. This is likely to be an ongoing issue and has now been referred to the competition commission;
- a ruling from the Court of Justice of the EU in March 2011 prohibiting new contracts issued after 21 December 2012 from using gender-based factors in the calculation of individuals' premiums and benefits;
- in addition the Association of British Insurers has entered into a non-statutory agreement with the UK Government to improve customer confidence in the pricing of motor and travel insurance in the light or evidence of a perception among some customers that changes in motor and travel insurance premiums due to a person's age are not always proportionate to risk and the cost of claims;
- the EU is in the process of developing and implementing a new regime in relation to solvency requirements and other matters affecting the financial strength of insurers ("Solvency II") within each member state, with currently uncertain implementation timelines and ultimate requirements;
- the uncertainty surrounding the impact of the Lord Justice Jackson report on the proposed ban on referral fees;
- other regulatory concerns including the current review by the FSA on the way in which family legal protection and motor legal protection insurance are sold to customers to ensure these products meet customers' needs;
- there is a risk that the recent European Community proposals on data protection as currently drafted will impose a disproportionate burden on insurers. These proposals could impact on the ability of insurers to share information to prevent fraud and other financial crime;
- the current flood insurance Statement of Principles agreement with the Government effective from 2000 ends in June 2013. Until then insurers will continue to offer flood insurance to existing customers including those at high risk (up to a 1 in 75 year flood risk probability). Further uncertainty remains as to what will replace the Statement of Principles;
- the Lord Chancellor has announced a review of the approach to setting the Ogden discount rate. Changes to the rate would particularly affect the cost of bodily injury claims. The Ministry of Justice, the Scottish Government and the Department of Justice, Northern Ireland, released a paper on 1 August 2012, to gain the views of people and organisations with an interest in personal injury claims and damages in the UK regarding the methodology to be used in setting the Ogden discount rate. This consultation paper will be used by the Lord Chancellor and his counterparts in setting the discount rate for personal injury damages in their respective jurisdictions. The consultation period is due to end on 23 October 2012. Independently of this consultation and the review of the amount of the prescribed discount rate of which it forms part, the Ministry of Justice intends to issue a consultation paper in the autumn of 2012 to review the present legal basis for the setting of the rate in England and Wales. The consultation will seek views on whether the restrictions on the factors that can be taken into account in prescribing a rate under section 1 of the Damages Act 1996 are still appropriate;
- the Legal Aid, Sentencing and Punishment of Offenders Bill 2011, has been reviewed by the House of Lords/Commons and received Royal Assent. It will now become the Legal Aid, Sentencing and Punishment of Offenders Act 2012. However, the Statutory Instrument has yet to be published. When it is, it is expected that the bill will become law in April 2013. The bill includes the ban on

3. MANAGEMENT OF INSURANCE, FINANCIAL AND OPERATIONAL RISK (Continued)

recoverability of CFA success fees, ATE premiums from defendants in civil litigation and a ban on referral fees being paid for Bodily Injury cases. The Bill also contains a number of new measures to protect the public and reduce reoffending including Reforming the Rehabilitation of Offenders Act, to help ex-offenders reintegrate into society after their sentences; and

- the 1974 Rehabilitation of Offenders Act which dictates when a conviction is "spent" and has a sliding timescale depending on the seriousness of the crime has been reviewed and the periods after which convicted criminals no longer have to declare their past offending are to be significantly cut. This will materially impact the data that will have to be provided to Insurers.

3.10 Capital adequacy

The Group defines capital requirement in accordance with regulations prescribed by the FSA, other regulatory bodies and the credit rating agencies. Capital is managed in accordance with the Group's capital management Minimum Standard, the objective of which is to manage capital efficiently and maintain an appropriate level of capitalisation and solvency.

The Group determines the appropriate level of capital on the basis of a number of criteria including its risk-based requirement, the maintenance of a prudent excess versus regulatory capital requirements, and its capital risk appetite statement of ensuring consistency with a credit rating in the "A" range. The Group seeks to hold capital coverage in the range of 125% - 150% of risk-based capital requirement. The Group also manages its subsidiaries on an ongoing basis to ensure that capital resources exceed regulatory minima in accordance with its risk appetite.

The Group uses a risk based capital model to determine how much capital it needs to maintain in order to operate in accordance with its risk strategy for the UK general insurance underwriters established within its ERM framework. The risk-based capital model also supports decision-making in the business. In addition, the Group also monitors financial resources with reference to the requirements of the IGD.

The UK regulated insurance entities of the Group carry out an assessment of the adequacy of their overall financial resources in accordance with the FSA's ICA methodology. For the UK, this is based on an internal capital model which is calibrated, as required by the FSA, to a 99.5% confidence interval over a one year time horizon. As stated above, the Group's capital risk appetite is to hold capital consistent with the Group maintaining a credit rating in the "A" range and as such its capital resources are in excess of the ICA requirement. The capital for European entities is maintained in accordance with the local regulatory solvency requirements.

The Group held a surplus as at 30 June 2012 of at least £2,221.7 million (31 December 2011: £2,363.6 million; 2010: £1,563.9 million; 2009: £1,952.2 million) above its IGD requirement of £1,079.0 million (31 December 2011: £1,079.1 million; 2010: £1,227.3 million; 2009: £1,049.5 million).

Management information to monitor the Group's capital requirements and solvency position is produced and presented to ALCO on a regular basis.

4. SEGMENTAL ANALYSIS

The Group is a general insurer with leading direct market positions in the UK, Italy and Germany. The Group utilises a multi-brand, multi-product, multi-distribution channel business model that covers most major customer segments in the UK for personal lines general insurance and a more limited presence in the commercial market.

The directors manage the Group primarily by product type and present the segmental analysis on that basis. The segments reflect the management structure whereby a member of the Executive management team is accountable to the Group Chief Executive Officer for each of the following operating segments:

4. SEGMENTAL ANALYSIS (Continued)

Motor

This segment consists of personal car insurance cover together with the associated legal expenses business. The Group sells motor insurance through its own brands–Direct Line, Churchill and Privilege–and through partnerships or aggregators. As a result, the Group has a brand and product offering that covers most major retail customer segments for motor insurance in the UK.

Home

This segment consists of the underwriting of home insurance cover. The Group sells home insurance through its own brands–Direct Line, Churchill, and Privilege–and through partnerships or aggregators. The Group's brand and product offering covers most major retail customer segments for home insurance in the UK.

Rescue and other personal lines

This segment consists of the underwriting of rescue and recovery insurance products and other personal lines business (including travel, pet, life business (closed for new business), and creditor).

The Group sells rescue and recovery insurance as a stand-alone product through the Green Flag brand or as an insurance add-on to all Group own-brand and certain partner motor policies, or as part of packaged bank accounts. Rescue insurance policies range from basic roadside rescue to a full Europe-wide breakdown recovery service.

The Group sells its other personal lines insurance through its own brands–Direct Line, Churchill and Privilege–and through partnerships.

Commercial

This segment consists of the underwriting of commercial insurance for micro and small medium enterprises in the UK. The Group sells commercial products through its own brands–NIG and Direct Line for Business–and through its partnership with RBS and NatWest.

International

This segment consists primarily of motor insurance, sold to private customers in Germany and Italy using a multi-channel strategy through the Direct Line brand and through partnerships and aggregators.

Notes to the segmental analysis

Certain charges are not allocated to the specific operating segments above as they are considered by management to be outside of underlying business activities by virtue of their one-off incidence, size or nature. Such charges are categorised as run-off and restructuring and other one-off items, as described below:

Run-off

The businesses included in the run-off segment consist of two principal lines, being policies written through partnership arrangements with TPF and NIG personal lines business sold via brokers, both of which are now in run-off. TPF was entered into as a 50:50 joint venture with Tesco in 1999, whereby the Group underwrote a range of general and life insurance products under the Tesco brand to Tesco customers. The operations of the Group's Spanish joint venture, Linea Directa Aseguradora S.A were included until its disposal in April 2009.

Restructuring and other one-off costs

Costs included within restructuring and other one-off costs include items that are exceptional in nature, including additional expenses as a result of separation from RBS Group and impairment of goodwill.

4. SEGMENTAL ANALYSIS (Continued)

No inter-segment transactions occurred in the periods ending 2012, 2011, 2010 and 2009. If any transaction were to occur, transfer prices between operating segments are set on an arm's length basis in a manner similar to transactions with third parties. Segment income, expenses and results will include those transfers between business segments which will then be eliminated on consolidation.

For each operating segment, there is no individual policyholder or customer that represents 10% or more of the Group's total revenue.

The following is an analysis of the Group's revenue and results by reportable segment for the six months ended 30 June 2012:

	Motor £ Million	Home £ Million	Rescue and other personal lines £ Million	Commercial £ Million	International £ Million	Total Ongoing £ Million	Run-off £ Million	Restructuring and other one-off costs £ Million	Total Group £ Million
Gross written premium	842.1	484.4	199.3	229.8	302.8	2,058.4	4.1	—	2,062.5
Gross earned premium	840.2	504.3	201.7	215.2	260.7	2,022.1	12.6	—	2,034.7
Reinsurance premium ceded	(22.4)	(26.9)	(10.0)	(16.6)	(85.4)	(161.3)	(3.2)	—	(164.5)
Net earned premium	**817.8**	**477.4**	**191.7**	**198.6**	**175.3**	**1,860.8**	**9.4**	**—**	**1,870.2**
Investment return	86.4	22.2	4.2	19.0	13.6	145.4	30.6	—	176.0
Instalment income and other operating income	79.3	12.8	(1.6)	4.8	3.5	98.8	0.3	—	99.1
Total income	**983.5**	**512.4**	**194.3**	**222.4**	**192.4**	**2,105.0**	**40.3**	**—**	**2,145.3**
Insurance claims	(698.4)	(314.9)	(103.2)	(153.6)	(207.4)	(1,477.5)	(31.6)	—	(1,509.1)
Insurance claims recoverable from reinsurers	105.8	11.6	12.3	24.8	69.9	224.4	60.6	—	285.0
Net insurance claims	**(592.6)**	**(303.3)**	**(90.9)**	**(128.8)**	**(137.5)**	**(1,253.1)**	**29.0**	**—**	**(1,224.1)**
Commission expenses	(9.3)	(77.4)	(9.6)	(39.7)	(19.9)	(155.9)	(66.1)	—	(222.0)
Other operating expenses	(235.4)	(113.3)	(44.6)	(55.3)	(23.2)	(471.8)	(2.0)	(108.7)	(582.5)
Total expenses	**(244.7)**	**(190.7)**	**(54.2)**	**(95.0)**	**(43.1)**	**(627.7)**	**(68.1)**	**(108.7)**	**(804.5)**
Operating profit / (loss)	**146.2**	**18.4**	**49.2**	**(1.4)**	**11.8**	**224.2**	**1.2**	**(108.7)**	**116.7**
Finance costs									(10.2)
Profit before tax									**106.5**
Loss ratio	72.5%	63.5%	47.4%	64.9%	78.4%	67.3%			
Commission ratio	1.1%	16.2%	5.0%	20.0%	11.4%	8.4%			
Expense ratio	28.8%	23.7%	23.3%	27.8%	13.2%	25.4%			
Combined operating ratio	102.4%	103.4%	75.7%	112.7%	103.0%	101.1%			

4. SEGMENTAL ANALYSIS (Continued)

The following is an analysis of the Group's revenue and results by reportable segment for the six months ended 30 June 2011 (unaudited):

	Motor £ Million	Home £ Million	Rescue and other personal lines £ Million	Commercial £ Million	International £ Million	Total Ongoing £ Million	Run-off £ Million	Restructuring and other one-off costs £ Million	Total Group £ Million
Gross written premium	866.0	500.8	192.5	231.9	302.0	2,093.2	26.1	—	2,119.3
Gross earned premium	916.7	512.2	202.4	204.9	222.0	2,058.2	309.7	—	2,367.9
Reinsurance premium ceded	(8.9)	(27.5)	(9.8)	(12.5)	(55.8)	(114.5)	(13.0)	—	(127.5)
Net earned premium	**907.8**	**484.7**	**192.6**	**192.4**	**166.2**	**1,943.7**	**296.7**	**—**	**2,240.4**
Investment return	74.6	17.4	6.7	14.4	12.4	125.5	21.4	—	146.9
Instalment income and other operating income	111.6	16.0	0.9	2.2	3.5	134.2	(11.2)	—	123.0
Total income	**1,094.0**	**518.1**	**200.2**	**209.0**	**182.1**	**2,203.4**	**306.9**	**—**	**2,510.3**
Insurance claims	(766.7)	(311.0)	(122.8)	(115.7)	(188.8)	(1,505.0)	(264.1)	—	(1,769.1)
Insurance claims recoverable from reinsurers	7.5	(1.5)	11.2	2.0	42.9	62.1	6.6	—	68.7
Net insurance claims	**(759.2)**	**(312.5)**	**(111.6)**	**(113.7)**	**(145.9)**	**(1,442.9)**	**(257.5)**	**—**	**(1,700.4)**
Commission expenses	(9.8)	(79.8)	(9.0)	(42.2)	(9.4)	(150.2)	(34.1)	—	(184.3)
Other operating expenses	(202.0)	(85.4)	(37.9)	(43.7)	(31.8)	(400.8)	(27.7)	(9.8)	(438.3)
Total expenses	**(211.8)**	**(165.2)**	**(46.9)**	**(85.9)**	**(41.2)**	**(551.0)**	**(61.8)**	**(9.8)**	**(622.6)**
Operating profit / (loss)	**123.0**	**40.4**	**41.7**	**9.4**	**(5.0)**	**209.5**	**(12.4)**	**(9.8)**	**187.3**
Finance costs									(1.4)
Gain on disposal of subsidiary									1.6
Profit before tax									**187.5**
Loss ratio	83.6%	64.5%	58.0%	59.1%	87.8%	74.2%			
Commission ratio	1.1%	16.5%	4.7%	21.9%	5.6%	7.7%			
Expense ratio	22.3%	17.6%	19.7%	22.7%	19.1%	20.6%			
Combined operating ratio	107.0%	98.6%	82.4%	103.7%	112.5%	102.5%			

4. SEGMENTAL ANALYSIS (Continued)

The following is an analysis of the Group's revenue and results by reportable segment for the year ended 31 December 2011:

	Motor £ Million	Home £ Million	Rescue and other personal lines £ Million	Commercial £ Million	International £ Million	Total Ongoing £ Million	Run-off £ Million	Restructuring and other one-off costs £ Million	Total Group £ Million
Gross written premium	1,734.8	1,031.3	350.2	438.6	570.0	4,124.9	43.4	—	4,168.3
Gross earned premium	1,797.4	1,031.1	410.3	420.5	482.8	4,142.1	380.8	—	4,522.9
Reinsurance premium ceded	(25.8)	(57.0)	(19.5)	(27.8)	(121.1)	(251.2)	(18.7)	—	(269.9)
Net earned premium	**1,771.6**	**974.1**	**390.8**	**392.7**	**361.7**	**3,890.9**	**362.1**	**—**	**4,253.0**
Investment return	145.2	28.5	9.5	30.5	25.0	238.7	43.2	—	281.9
Instalment income and other operating income	208.2	35.1	—	5.0	7.2	255.5	(15.4)	—	240.1
Total income	**2,125.0**	**1,037.7**	**400.3**	**428.2**	**393.9**	**4,385.1**	**389.9**	**—**	**4,775.0**
Insurance claims	(1,501.6)	(579.2)	(195.7)	(268.6)	(391.4)	(2,936.5)	(224.1)	—	(3,160.6)
Insurance claims recoverable from reinsurers	54.8	19.9	22.1	11.9	96.8	205.5	(12.4)	—	193.1
Net insurance claims	**(1,446.8)**	**(559.3)**	**(173.6)**	**(256.7)**	**(294.6)**	**(2,731.0)**	**(236.5)**	**—**	**(2,967.5)**
Commission expenses	(25.9)	(170.0)	(87.8)	(82.3)	(28.6)	(394.6)	(124.3)	—	(518.9)
Other operating expenses	(397.5)	(196.5)	(75.6)	(101.6)	(66.4)	(837.6)	(53.0)	(54.0)	(944.6)
Total expenses	**(423.4)**	**(366.5)**	**(163.4)**	**(183.9)**	**(95.0)**	**(1,232.2)**	**(177.3)**	**(54.0)**	**(1,463.5)**
Operating profit / (loss)	**254.8**	**111.9**	**63.3**	**(12.4)**	**4.3**	**421.9**	**(23.9)**	**(54.0)**	**344.0**
Finance costs									(2.7)
Gain on disposal of subsidiary									1.6
Profit before tax									**342.9**
Loss ratio	81.7%	57.4%	44.4%	65.4%	81.4%	70.2%			
Commission ratio	1.5%	17.5%	22.5%	21.0%	7.9%	10.1%			
Expense ratio	22.4%	20.2%	19.4%	25.9%	18.3%	21.5%			
Combined operating ratio	105.6%	95.1%	86.3%	112.3%	107.6%	101.8%			

4. SEGMENTAL ANALYSIS (Continued)

The following is an analysis of the Group's revenue and results by reportable segment for year ended 31 December 2010:

	Motor £ Million	Home £ Million	Rescue and other personal lines £ Million	Commercial £ Million	International £ Million	Total Ongoing £ Million	Run-off £ Million	Restructuring and other one-off costs £ Million	Total Group £ Million
Gross written premium	1,902.2	1,034.4	335.5	397.7	425.5	4,095.3	875.7	—	4,971.0
Gross earned premium	1,932.4	1,018.7	413.9	393.1	361.1	4,119.2	1,033.2	—	5,152.4
Reinsurance premium ceded	(9.9)	(48.6)	(20.9)	(21.0)	(42.0)	(142.4)	(36.5)	—	(178.9)
Net earned premium	**1,922.5**	**970.1**	**393.0**	**372.1**	**319.1**	**3,976.8**	**996.7**	**—**	**4,973.5**
Investment return	176.3	39.8	20.2	20.4	24.7	281.4	40.3	—	321.7
Instalment income and other operating income	255.7	36.1	11.8	18.9	6.6	329.1	(33.9)	—	295.2
Total income	**2,354.5**	**1,046.0**	**425.0**	**411.4**	**350.4**	**4,587.3**	**1,003.1**	**—**	**5,590.4**
Insurance claims	(2,404.8)	(585.0)	(236.1)	(282.3)	(289.9)	(3,798.1)	(1,086.6)	—	(4,884.7)
Insurance claims recoverable from reinsurers	96.4	41.7	32.9	20.9	17.9	209.8	46.9	—	256.7
Net insurance claims	**(2,308.4)**	**(543.3)**	**(203.2)**	**(261.4)**	**(272.0)**	**(3,588.3)**	**(1,039.7)**	**—**	**(4,628.0)**
Commission expenses	(37.3)	(156.1)	(68.5)	(81.7)	(9.3)	(352.9)	(25.8)	—	(378.7)
Other operating expenses	(425.7)	(183.5)	(70.3)	(109.1)	(63.2)	(851.8)	(78.3)	(29.0)	(959.1)
Total expenses	**(463.0)**	**(339.6)**	**(138.8)**	**(190.8)**	**(72.5)**	**(1,204.7)**	**(104.1)**	**(29.0)**	**(1,337.8)**
Operating (loss) / profit	**(416.9)**	**163.1**	**83.0**	**(40.8)**	**5.9**	**(205.7)**	**(140.7)**	**(29.0)**	**(375.4)**
Finance costs									(2.7)
Loss before tax									**(378.1)**
Loss ratio	120.1%	56.0%	51.7%	70.3%	85.2%	90.2%			
Commission ratio	1.9%	16.1%	17.4%	22.0%	2.9%	8.9%			
Expense ratio	22.1%	18.9%	17.9%	29.3%	19.8%	21.4%			
Combined operating ratio	144.1%	91.0%	87.0%	121.6%	107.9%	120.5%			

4. SEGMENTAL ANALYSIS (Continued)

The following is an analysis of the Group's revenue and results by reportable segment for year ended 31 December 2009:

	Motor £ Million	Home £ Million	Rescue and other personal lines £ Million	Commercial £ Million	International £ Million	Total Ongoing £ Million	Run-off £ Million	Restructuring and other one-off costs £ Million	Total Group £ Million
Gross written premium	2,067.2	1,030.9	320.9	398.9	353.7	4,171.6	1,119.5	—	5,291.1
Gross earned premium	2,012.2	1,009.0	436.6	401.1	340.2	4,199.1	1,131.3	—	5,330.4
Reinsurance premium ceded	(23.9)	(54.3)	(22.0)	(20.0)	(49.1)	(169.3)	(32.8)	—	(202.1)
Net earned premium	**1,988.3**	**954.7**	**414.6**	**381.1**	**291.1**	**4,029.8**	**1,098.5**	**—**	**5,128.3**
Investment return	166.6	51.4	28.0	35.4	24.9	306.3	59.3	—	365.6
Instalment income and other operating income	211.7	32.8	12.2	1.7	8.1	266.5	(32.0)	—	234.5
Total income	**2,366.6**	**1,038.9**	**454.8**	**418.2**	**324.1**	**4,602.6**	**1,125.8**	**—**	**5,728.4**
Insurance claims	(2,013.6)	(526.9)	(264.6)	(250.9)	(263.8)	(3,319.8)	(981.9)	—	(4,301.7)
Insurance claims recoverable from reinsurers	25.9	7.1	13.4	11.7	21.4	79.5	39.9	—	119.4
Net insurance claims	**(1,987.7)**	**(519.8)**	**(251.2)**	**(239.2)**	**(242.4)**	**(3,240.3)**	**(942.0)**	**—**	**(4,182.3)**
Commission expenses	(31.0)	(161.8)	(17.4)	(79.8)	(10.9)	(300.9)	(259.9)	—	(560.8)
Other operating expenses	(479.9)	(186.5)	(71.0)	(93.9)	(64.5)	(895.8)	(89.0)	(80.0)	(1,064.8)
Total expenses	**(510.9)**	**(348.3)**	**(88.4)**	**(173.7)**	**(75.4)**	**(1,196.7)**	**(348.9)**	**(80.0)**	**(1,625.6)**
Operating (loss) / profit	**(132.0)**	**170.8**	**115.2**	**5.3**	**6.3**	**165.6**	**(165.1)**	**(80.0)**	**(79.5)**
Finance costs									(4.4)
Gain on disposal of joint venture									216.1
Profit before tax									**132.2**
Loss ratio	100.0%	54.4%	60.6%	62.8%	83.3%	80.4%			
Commission ratio	1.6%	16.9%	4.2%	20.9%	3.8%	7.5%			
Expense ratio	24.1%	19.5%	17.1%	24.6%	22.1%	22.2%			
Combined operating ratio	125.7%	90.8%	81.9%	108.3%	109.2%	110.1%			

Segmental assets and liabilities

The identifiable segment assets and liabilities as at 30 June 2012 are as follows:

	Motor £ Million	Home £ Million	Rescue and other personal lines £ Million	Commercial £ Million	International £ Million	Run-off £ Million	Total Group £ Million
Goodwill	126.4	45.8	28.7	10.1	—	—	211.0
Other segment assets	6,818.5	1,461.5	284.0	1,388.3	1,189.1	1,857.9	12,999.3
Segment liabilities	(5,232.4)	(1,121.4)	(217.9)	(1,065.2)	(988.4)	(1,420.8)	(10,046.1)
Reportable segment net assets	**1,712.5**	**385.9**	**94.8**	**333.2**	**200.7**	**437.1**	**3,164.2**

4. SEGMENTAL ANALYSIS (Continued)

The identifiable segment assets and liabilities as at 31 December 2011 are as follows:

	Motor £ Million	Home £ Million	Rescue and other personal lines £ Million	Commercial £ Million	International £ Million	Run-off £ Million	Total Group £ Million
Goodwill	126.4	45.8	28.7	10.1	—	—	211.0
Other segment assets	7,241.2	1,565.9	316.7	1,486.4	1,070.8	1,878.1	13,559.1
Segment liabilities	(5,204.5)	(1,138.5)	(244.0)	(1,057.1)	(871.3)	(1,383.4)	(9,898.8)
Reportable segment net assets	**2,163.1**	**473.2**	**101.4**	**439.4**	**199.5**	**494.7**	**3,871.3**

The identifiable segment assets and liabilities as at 31 December 2010 are as follows:

	Motor £ Million	Home £ Million	Rescue and other personal lines £ Million	Commercial £ Million	International £ Million	Run-off £ Million	Total Group £ Million
Goodwill	136.6	45.8	28.7	10.1	—	—	221.2
Other segment assets	6,695.7	1,522.3	419.3	1,334.0	933.0	2,691.4	13,595.7
Segment liabilities	(4,981.6)	(1,143.3)	(326.7)	(980.0)	(742.8)	(2,160.4)	(10,334.8)
Reportable segment net assets	**1,850.7**	**424.8**	**121.3**	**364.1**	**190.2**	**531.0**	**3,482.1**

The identifiable segment assets and liabilities as at 31 December 2009 are as follows:

	Motor £ Million	Home £ Million	Rescue and other personal lines £ Million	Commercial £ Million	International £ Million	Run-off £ Million	Total Group £ Million
Goodwill	144.1	45.8	30.5	10.1	—	—	230.5
Other segment assets	5,885.1	1,569.2	615.5	1,281.9	905.5	2,698.1	12,955.3
Segment liabilities	(4,274.9)	(1,145.1)	(458.0)	(916.0)	(707.0)	(2,104.2)	(9,605.2)
Reportable segment net assets	**1,754.3**	**469.9**	**188.0**	**376.0**	**198.5**	**593.9**	**3,580.6**

All operations are in the UK except for International which operates in Germany and Italy.

The reportable segment net assets do not represent the Group's view of the capital requirements for its operating segments.

5. NET EARNED PREMIUM

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Premium income from insurance contracts issued:					
Premium receivables	2,062.4	2,119.3	4,168.3	4,971.0	5,291.1
Change in unearned premium reserve	(27.7)	248.6	354.6	181.4	39.3
	2,034.7	2,367.9	4,522.9	5,152.4	5,330.4
Premium revenue ceded to reinsurers on insurance contracts issued:					
Premium payables	(170.1)	(96.5)	(257.1)	(183.5)	(199.6)
Change in unearned premium reserve	5.6	(31.0)	(12.8)	4.6	(2.5)
	(164.5)	(127.5)	(269.9)	(178.9)	(202.1)
Net earned premium	**1,870.2**	**2,240.4**	**4,253.0**	**4,973.5**	**5,128.3**

6. INVESTMENT RETURN

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Investment income:					
Interest income on debt securities	92.1	109.8	208.1	229.0	228.7
Dividend income from equities	—	—	—	—	3.9
Other investment fund income	3.1	3.7	8.5	10.2	13.8
Cash and cash equivalent interest income	11.5	8.4	20.4	22.8	60.8
Property	3.5	3.6	6.6	7.1	7.1
Total	**110.2**	**125.5**	**243.6**	**269.1**	**314.3**
Net realised gains:					
Debt securities	41.5	21.4	54.3	68.2	22.0
Equity	—	—	—	—	48.4
Other*	23.2	—	—	0.1	—
Derivatives	1.9	—	—	—	—
Impairments on available-for-sale financial assets	—	—	(2.0)	(21.4)	(8.3)
Net unrealised (losses) / gains in:					
Derivatives	(0.8)	—	—	—	—
Investment property (note 18)	—	—	(14.0)	5.7	(10.8)
Total investment return	**176.0**	**146.9**	**281.9**	**321.7**	**365.6**

There are no impairments on available-for-sale financial assets for the six months ended 30 June 2012. For the years ended 31 December 2011 and 2010 the impairments to available-for-sale financial assets related to debt securities and for the year ended 31 December 2009, to equity securities.

* Other net realised gains are in relation to the sale of other investment funds in June 2012.

7. OTHER OPERATING INCOME

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Instalment income	62.1	76.7	145.0	187.7	155.9
Solicitors' referral fee income	11.0	14.6	27.9	39.4	31.0
Vehicle replacement referral income	8.5	10.9	21.9	20.0	—
Revenue from vehicle recovery and repair services	14.8	16.4	39.3	32.9	33.5
Fee income from insurance intermediary services	0.7	2.5	3.4	10.2	13.3
Other income	2.0	1.9	2.6	5.0	0.8
Total other operating income	**37.0**	**46.3**	**95.1**	**107.5**	**78.6**

8. INSURANCE CLAIMS

	Six months ended 30 June 2012		
	Gross £ Million	Reinsurance £ Million	Net £ Million
Current accident year claims paid	466.8	(28.0)	438.8
Prior accident years' claims paid	1,020.0	(38.0)	982.0
Movement in claims provision	22.3	(219.0)	(196.7)
Total insurance claims	**1,509.1**	**(285.0)**	**1,224.1**

	Six months ended 30 June 2011 (unaudited)		
	Gross £ Million	Reinsurance £ Million	Net £ Million
Current accident year claims paid	610.2	(21.7)	588.5
Prior accident years' claims paid	1,309.0	(22.2)	1,286.8
Movement in claims provision	(150.1)	(24.8)	(174.9)
Total insurance claims	**1,769.1**	**(68.7)**	**1,700.4**

	Year ended 31 December 2011		
	Gross £ Million	Reinsurance £ Million	Net £ Million
Current accident year claims paid	1,646.5	(113.2)	1,533.3
Prior accident years' claims paid	1,976.4	(37.4)	1,939.0
Movement in claims provision	(462.3)	(42.5)	(504.8)
Total insurance claims	**3,160.6**	**(193.1)**	**2,967.5**

	Year ended 31 December 2010		
	Gross £ Million	Reinsurance £ Million	Net £ Million
Current accident year claims paid	2,026.4	(37.5)	1,988.9
Prior accident years' claims paid	1,800.5	(28.3)	1,772.2
Movement in claims provision	1,057.8	(190.9)	866.9
Total insurance claims	**4,884.7**	**(256.7)**	**4,628.0**

8. INSURANCE CLAIMS (Continued)

	Year ended 31 December 2009		
	Gross £ Million	Reinsurance £ Million	Net £ Million
Current accident year claims paid	2,106.9	(34.5)	2,072.4
Prior accident years' claims paid	1,721.6	(52.3)	1,669.3
Movement in claims provision	473.2	(32.6)	440.6
Total insurance claims	**4,301.7**	**(119.4)**	**4,182.3**

Loss adjustment expenses for the six months ended 30 June 2012 of £124.2 million (six months ended 30 June 2011 (unaudited): £140.1 million and the years ended 31 December 2011: £296.4 million; 2010: £237.9 million; 2009: £226.6 million) have been included in the accident year claims figures above.

An increase in the liability adequacy provision for the six months ended 30 June 2012 of £8.2 million (six months ended 30 June 2011 (unaudited): £10.3 million reduction and the years ended 31 December 2011: £21.8 million reduction; 2010: £3.6 million reduction; 2009: £24.1 million charge) have been included in the movement in claims provision.

9. COMMISSION EXPENSES

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Commission expenses	144.6	168.4	324.5	395.6	411.7
Expenses incurred / (recovered) under profit participations	77.4	15.9	194.4	(16.9)	149.1
Total commission expenses	**222.0**	**184.3**	**518.9**	**378.7**	**560.8**

10. OTHER OPERATING EXPENSES

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Staff costs	214.9	149.5	321.6	312.6	289.3
Marketing	120.7	104.7	203.5	202.5	218.5
Management fees	145.5	134.8	282.0	326.6	336.6
Depreciation (note 17)	4.9	5.4	10.4	11.1	11.9
Amortisation and impairment of other intangible assets (note 16)	14.3	7.1	29.8	21.0	21.8
Impairment of goodwill (note 16)	—	—	10.2	9.3	66.8
Other sundry operating expenses	82.2	36.8	87.1	76.0	119.9
Total other operating expenses	**582.5**	**438.3**	**944.6**	**959.1**	**1,064.8**

Staff costs attributable to claims handling activities are allocated to claims and loss adjustment expenses.

Management fees are in respect of expenses recharged from RBS Group. Such fees are charged on an arm's length basis.

10. OTHER OPERATING EXPENSES (Continued)

Included in other operating expenses are run-off, restructuring and other one-off costs as follows:

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Staff costs	58.9	9.5	33.0	31.2	21.8
Management fees	16.3	22.0	42.0	59.2	68.2
Depreciation	—	—	—	—	1.2
Impairment of goodwill	—	—	10.2	9.3	66.8
Other sundry operating expenses	35.5	5.9	21.8	7.6	11.0
Total	**110.7**	**37.4**	**107.0**	**107.3**	**169.0**

	Six months ended 30 June		Year ended 31 December		
Average number of persons employed	2012 Number	2011 Number (unaudited)	2011 Number	2010 Number	2009 Number
Operations	13,967	14,875	14,765	15,810	16,503
Support	1,858	1,451	1,552	1,272	1,357
Total	**15,825**	**16,326**	**16,317**	**17,082**	**17,860**

Their aggregate remuneration comprised:

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Wages and salaries	211.5	198.2	425.3	415.2	418.9
Social security costs	23.9	20.2	47.6	44.6	45.4
Other pension costs	50.8	19.3	41.6	40.2	39.5
Total	**286.2**	**237.7**	**514.5**	**500.0**	**503.8**

Auditor's remuneration

	Six months ended 30 June	Year ended 31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Fees payable to Deloitte LLP for the statutory audit	0.5	1.3	1.4	1.4
Fees payable to Deloitte LLP for other services to the Group				
FSA returns	0.1	0.2	0.1	0.1
Other	1.9	1.3	1.5	—

Other includes fees payable relating to a review of the implementation of new claims systems and the divestment of the Group from RBS Group.

10. OTHER OPERATING EXPENSES (Continued)

Aggregate directors' emoluments

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Fees as directors	0.1	—	0.1	0.1	0.1
Other emoluments	1.6	1.3	3.0	1.4	1.3
Company pension contributions	0.1	0.1	0.2	0.1	0.2
Total	**1.8**	**1.4**	**3.3**	**1.6**	**1.6**

Included in the above are emoluments, excluding pension contributions, paid to the highest paid director for the six months ended 30 June 2012 amounting to £910,106 (six months ended 30 June 2011 (unaudited): £844,909; years ended 31 December 2011: £1,497,310; 2010: £919,275; 2009: £438,132). A contribution for the six months ended 30 June 2012 of £nil (six months ended 30 June 2011 (unaudited): £nil, years ended 31 December 2011: £nil; 2010: £100,000; 2009: £76,584) was made to a final salary scheme on behalf of the highest paid director. As at 30 June 2012, three directors (2011: three; 2010: one; 2009: none) had retirement benefits accruing under money purchase pension schemes in respect of qualifying service.

During the six months ended 30 June 2012 no directors exercised options (six months ended 30 June 2011 (unaudited), years ended 31 December 2011, 2010 and 2009: none).

11. FINANCE COSTS

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Interest expense:					
Interest expense on subordinated dated notes	7.4	—	—	—	—
Interest expense on related party borrowings (note 39)	2.7	1.2	2.3	2.2	3.8
Other	0.1	0.2	0.4	0.5	0.6
Total finance costs	**10.2**	**1.4**	**2.7**	**2.7**	**4.4**

12. TAX CHARGE / (CREDIT)

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Current taxation:					
Charge / (credit) for the period	29.2	48.8	157.2	(104.7)	(6.0)
(Over) / under-provision in respect of prior period	(4.4)	—	10.8	4.0	5.7
	24.8	48.8	168.0	(100.7)	(0.3)
Deferred taxation (note 13):					
(Credit) / charge for the period	(1.1)	(3.5)	(56.1)	(0.5)	8.5
Over-provision in respect of prior period	—	—	(18.0)	(5.0)	(9.1)
	(1.1)	(3.5)	(74.1)	(5.5)	(0.6)
Current taxation	24.8	48.8	168.0	(100.7)	(0.3)
Deferred taxation (note 13)	(1.1)	(3.5)	(74.1)	(5.5)	(0.6)
Tax charge / (credit) for the period	**23.7**	**45.3**	**93.9**	**(106.2)**	**(0.9)**

The actual income tax charge differs from the expected income tax charge computed by applying the standard rate of UK corporation tax for the six months ended 30 June 2012 of 24.5%* (six months ended 30 June 2011: 26.5% and the years ended 31 December 2011: 26.5%; 2010 and 2009: 28.0%) as follows:

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Expected tax charge / (credit)	26.1	49.7	90.9	(105.9)	37.0
Effects of:					
Net movement in impairment of goodwill	—	—	2.9	1.6	19.1
Realised gains on disposal of subsidiary and joint venture	—	—	0.4	—	(60.5)
Disallowable expenses	2.8	—	7.1	4.6	10.9
Non-taxable items	(0.7)	(1.9)	—	(3.9)	(4.0)
Effect on deferred tax balances due to the change in income tax rate	(0.1)	(2.5)	(0.2)	(1.6)	—
Over provision in respect of prior period	(4.4)	—	(7.2)	(1.0)	(3.4)
Tax charge / (credit)	**23.7**	**45.3**	**93.9**	**(106.2)**	**(0.9)**
Effective income tax rate	**22.3%**	**24.2%**	**27.4%**	**28.1%**	**(0.7)%**

The aggregate current and deferred tax relating to items that are charged or credited to other comprehensive income for the six months ended 30 June 2012 is £0.8 million credit (six months ended 30 June 2011 (unaudited): £12.8 million charge and the years ended 31 December 2011: £36.8 million charge; 2010: £27.4 million charge; 2009: £41.5 million charge).

* On 26 March 2012, the substantively enacted UK tax rate was reduced from 25% to 24% effective on 1 April 2012.

12. TAX CHARGE / (CREDIT) (Continued)

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Per balance sheet:				
Current tax assets	4.4	—	25.9	50.8
Current tax liabilities	(231.1)	(218.0)	(2.6)	(0.3)

13. DEFERRED TAXATION

The following are the deferred tax (assets) / liabilities recognised by the Group, and the movements thereon, during the current and prior reporting periods.

	Other timing differences £ Million	Retirement benefit obligation £ Million	Depreciation in excess of capital allowances £ Million	Non distributable reserves £ Million	Total £ Million
At 1 January 2009	22.9	(2.2)	(1.4)	44.1	**63.4**
(Credit) / charge to income statement	(8.7)	0.9	(0.1)	7.3	**(0.6)**
Credit to equity directly	(0.6)	(2.5)	—	—	**(3.1)**
At 31 December 2009	**13.6**	**(3.8)**	**(1.5)**	**51.4**	**59.7**
(Credit) / charge to income statement	(10.0)	0.9	0.1	3.5	**(5.5)**
Charge to equity directly	2.2	2.9	—	—	**5.1**
At 31 December 2010	**5.8**	**—**	**(1.4)**	**54.9**	**59.3**
(Credit) / charge to income statement	(28.3)	0.6	0.5	(46.9)	**(74.1)**
At 31 December 2011	**(22.5)**	**0.6**	**(0.9)**	**8.0**	**(14.8)**
(Credit) / charge to income statement	(6.7)	—	1.8	3.8	(1.1)
At 30 June 2012	**(29.2)**	**0.6**	**0.9**	**11.8**	**(15.9)**

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Per balance sheet				
Deferred tax assets	31.0	26.9	17.0	17.1
Deferred tax liabilities	(15.1)	(12.1)	(76.3)	(76.8)
	15.9	**14.8**	**(59.3)**	**(59.7)**

14. DIVIDENDS

	Six months ended 30 June 2012 £ Million
Ordinary dividend:	
Interim dividend paid in respect of current year of 20.0 pence per share, paid on 27 March 2012	300.0
Interim dividend paid in respect of current year of 33.3 pence per share, paid on 6 June 2012	500.0
Total	**800.0**

15. EARNINGS AND NET ASSETS PER SHARE, RETURN ON EQUITY

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Earnings / (loss) attributable to Owners of the Company	82.8	142.2	249.0	(271.9)	133.1

	Six months ended 30 June		Year ended 31 December		
	2012 Million	2011 Million (unaudited)	2011 Million	2010 Million	2009 Million
Weighted average number of ordinary shares in issue	1,500.0	1,500.0	1,500.0	1,500.0	1,500.0

	Six months ended 30 June		Year ended 31 December		
	2012 Pence	2011 Pence (unaudited)	2011 Pence	2010 Pence	2009 Pence
Basic and diluted earnings / (loss) per share	5.5	9.5	16.6	(18.1)	8.9

Basic and diluted earnings / (loss) per share are calculated by dividing the profit / (loss) attributable to Owners of the Company by the weighted average number of ordinary shares in issue during the period.

Net asset and net tangible asset value per share are as follows:

	Six months ended 30 June	Year ended 31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Net assets	2,905.7	3,612.8	3,223.6	3,322.1
Goodwill and other intangible assets	(390.9)	(365.8)	(286.1)	(290.3)
Net tangible assets	**2,514.8**	**3,247.0**	**2,937.5**	**3,031.8**
Net asset value per share (pence)	**193.7**	**240.9**	**214.9**	**221.5**
Net tangible asset value per share (pence)	**167.7**	**216.5**	**195.8**	**202.1**

Net asset value per share is calculated as total invested equity (excluding non-controlling interest) divided by the weighted average number of ordinary shares in issue during the period.

15. EARNINGS AND NET ASSETS PER SHARE, RETURN ON EQUITY (Continued)

Net tangible asset value per share is calculated as total invested equity (excluding non-controlling interest) less goodwill and other intangible assets divided by the weighted average number of ordinary shares in issue during the period.

Return on equity is as follows:

	Six months ended 30 June	Year ended 31 December		
	2012 Million	2011 Million	2010 Million	2009 Million
Profit / (loss) after tax for the period	**82.8**	**249.0**	**(271.9)**	**133.1**
Opening invested equity	3,612.8	3,223.6	3,322.1	2,931.6
Closing invested equity	2,905.7	3,612.8	3,223.6	3,322.1
Average invested equity	**3,259.2**	**3,418.2**	**3,272.9**	**3,126.9**
Adjustment for time weighting of dividends paid in the period	288.8	—	—	—
Weighted average invested equity	**3,548.0**	**3,418.2**	**3,272.9**	**3,126.9**
Return on equity	**4.7%***	**7.3%**	**(8.3)%**	**4.3%**

Return on equity is calculated as profit / (loss) after tax for the period divided by weighted average invested equity, expressed as a percentage.

On 31 August 2012, the share capital of the Company was subdivided from 1.5 billion ordinary shares of £1 to 1.5 billion ordinary shares of 10 pence and 1.5 billion deferred shares of 90 pence. The deferred shares were immediately cancelled. See note 40 for further details.

Note:

* Annualised

16. GOODWILL AND OTHER INTANGIBLE ASSETS

	Goodwill £ Million	Other intangible assets £ Million	Total £ Million
Cost			
At 1 January 2009	347.2	472.0	819.2
Exchange differences	(0.1)	(3.0)	(3.1)
Additions	—	8.1	8.1
Impairment and write off of intangible assets	—	(2.4)	(2.4)
Disposal of joint venture	—	(15.9)	(15.9)
At 31 December 2009	347.1	458.8	805.9
Exchange differences	(0.9)	(0.6)	(1.5)
Additions	—	26.2	26.2
Impairment and write off of intangible assets	—	(57.6)	(57.6)
At 31 December 2010	346.2	426.8	773.0
Exchange differences	(1.0)	(0.8)	(1.8)
Additions	—	119.8	119.8
Impairment and write off of intangible assets	—	(8.8)	(8.8)
At 31 December 2011	345.2	537.0	882.2
Exchange differences	(1.0)	(1.0)	(2.0)
Additions	—	39.6	39.6
At 30 June 2012	**344.2**	**575.6**	**919.8**

16. GOODWILL AND OTHER INTANGIBLE ASSETS (Continued)

	Goodwill £ Million	Other intangible assets £ Million	Total £ Million
Amortisation / accumulated impairment losses			
At 1 January 2009	42.1	394.6	436.7
Charge for the year	—	20.6	20.6
Exchange differences	7.7	(2.1)	5.6
Impaired and write off of intangible assets	66.8	(1.2)	65.6
Disposal of joint venture	—	(12.9)	(12.9)
At 31 December 2009	116.6	399.0	515.6
Charge for the year	—	18.5	18.5
Exchange differences	(0.9)	(0.5)	(1.4)
Impaired and write off of intangible assets	9.3	(55.1)	(45.8)
At 31 December 2010	125.0	361.9	486.9
Charge for the year	—	21.1	21.1
Exchange differences	(1.0)	(0.7)	(1.7)
Impaired and write off of intangible assets	10.2	(0.1)	10.1
At 31 December 2011	134.2	382.2	516.4
Charge for the period	—	14.3	14.3
Exchange differences	(1.0)	(0.8)	(1.8)
At 30 June 2012	**133.2**	**395.7**	**528.9**
Net book amount			
At 30 June 2012	**211.0**	**179.9**	**390.9**
At 31 December 2011	**211.0**	**154.8**	**365.8**
At 31 December 2010	**221.2**	**64.9**	**286.1**
At 31 December 2009	**230.5**	**59.8**	**290.3**

Other intangible assets primarily comprise software development costs and there were additions of £39.6 million in the period (years ended 31 December 2011: £119.8 million; 2010: £26.2 million; 2009: £8.1 million).

Goodwill has arisen primarily on the acquisition of U K Insurance Limited (£141 million) and Churchill Insurance Company Limited (£70 million), which is allocated across motor, home, rescue and other personal lines and commercial on a relative value basis.

The Group's goodwill is reviewed annually at 30 September for impairment by comparing the recoverable amount of each cash generating unit ("**CGU**") to which goodwill has been allocated on a relative basis with its carrying value and updated at each reporting date in the event of indicators of impairment.

16. GOODWILL AND OTHER INTANGIBLE ASSETS (Continued)

The goodwill of the CGUs of the Group is as follows:

	Motor £ Million	Home £ Million	Rescue and other personal lines £ Million	Commercial £ Million	Direct Line Insurance S.p.A £ Million	Direct Line Life Insurance Company Limited £ Million	Tracker Network (UK) Limited £ Million	Total £ Million
As at 1 January 2009	126.4	45.8	28.7	10.1	23.6	1.8	60.9	297.3
Impairment of goodwill	—	—	—	—	(23.6)	—	(43.2)	(66.8)
As at 31 December 2009	126.4	45.8	28.7	10.1	—	1.8	17.7	230.5
Impairment of goodwill	—	—	—	—	—	(1.8)	(7.5)	(9.3)
As at 31 December 2010	126.4	45.8	28.7	10.1	—	—	10.2	221.2
Impairment of goodwill	—	—	—	—	—	—	(10.2)	(10.2)
As at 31 December 2011	126.4	45.8	28.7	10.1	—	—	—	211.0
As at 30 June 2012	**126.4**	**45.8**	**28.7**	**10.1**	**—**	**—**	**—**	**211.0**

The recoverable amount is the higher of the unit's fair value less the costs to sell and its value in use. Value in use is the present value of expected future cash flows from the CGU. Fair value is the amount obtainable for the sale of the CGU in an arm's length transaction between knowledgeable and willing parties.

Impairment testing inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of CGUs; and the valuation of the separable assets of each business whose goodwill is being reviewed.

The recoverable amounts of all CGUs at 30 September were based on the value in use test, using management's latest five-year forecasts. The long-term growth rates have been based on GDP rates adjusted for inflation. The risk discount rates are based on observable market long-term government bond yields and average industry betas adjusted for an appropriate risk premium based on independent analysis.

The recoverable amount of the Motor business, based on a 3% terminal growth rate and a 10% post-tax discount rate, exceeded the carrying amount by £1,441.5 million. A 1% change in the discount rate or the terminal growth rate would change the recoverable amount by approximately £456.1 million and £468.1 million respectively. In addition, a 1% change in the forecast post-tax earnings would change the recoverable amount by approximately £36.0 million.

The recoverable amount of the Home business, based on a 3% terminal growth rate and a 10% post-tax discount rate, exceeded the carrying amount by £745.0 million. A 1% change in the discount rate or the terminal growth rate would change the recoverable amount by approximately £153.6 million and £157.8 million respectively. In addition, a 1% change in the forecast post-tax earnings would change the recoverable amount by approximately £12.2 million.

The recoverable amount of the Rescue and other personal lines business, based on a 3% terminal growth rate and a 10% post-tax discount rate, exceeded the carrying amount by £745.7 million. A 1% change in the discount rate or the terminal growth rate would change the recoverable amount by approximately £108.6 million and £111.8 million respectively. In addition, a 1% change in the forecast post-tax earnings would change the recoverable amount by approximately £8.5 million.

The recoverable amount of the Commercial business, based on a 3% terminal growth rate and a 10% post-tax discount rate, exceeded the carrying amount by £104.2 million. A 1% change in the discount rate or the terminal growth rate would change the recoverable amount by approximately £75.9 million and £78.9 million respectively. In addition, a 1% change in the forecast post-tax earnings would change the recoverable amount by approximately £5.4 million.

16. GOODWILL AND OTHER INTANGIBLE ASSETS (Continued)

Tracker Network UK limited ("**Tracker**") provides stolen vehicle recovery systems and vehicle asset management systems. Goodwill was fully impaired by 31 December 2011 (impairment charge 2011: £10.2 million; 2010: £7.5 million; 2009: £43.2 million) as performance was not in line with that anticipated at the date of purchase. The recoverable amount was calculated in each period using a value in use methodology, with the key assumptions underlying the calculation being a terminal growth rate (2011, 2010 and 2009: 3%) and a post-tax discount rate (2011: 10%; 2010: 10%; 2009: 12%).

For all other CGUs, key assumptions used in impairment testing in 2011, 2010 and 2009 were;

- terminal growth rate: 2011, 2010 and 2009: 3%; and
- post-tax discount rate: 2011, 2010: 10%; 2009: 12%.

17. PROPERTY, PLANT AND EQUIPMENT

	Property, Plant and Equipment £ Million
Cost	
At 1 January 2009	183.6
Additions	8.4
Disposals	(96.2)
Effect of foreign currency exchange adjustment	(3.6)
At 31 December 2009	**92.2**
Additions	5.2
Disposals	(5.3)
Effect of foreign currency exchange adjustment	(0.5)
At 31 December 2010	**91.6**
Additions	7.5
Disposals	(7.9)
Classified as held-for-sale	(1.5)
Effect of foreign currency exchange adjustment	(0.6)
At 31 December 2011	**89.1**
Additions	48.4
Disposals	(4.7)
Effect of foreign currency exchange adjustment	(1.5)
At 30 June 2012	**131.3**

17. PROPERTY, PLANT AND EQUIPMENT (Continued)

	Property, Plant and Equipment £ Million
Depreciation	
At 1 January 2009	97.0
Depreciation charge for the year	11.9
Disposals	(74.2)
Effect of foreign currency exchange adjustment	(1.7)
At 31 December 2009	33.0
Depreciation charge for the year	11.1
Disposals	(4.7)
Effect of foreign currency exchange adjustment	(0.4)
At 31 December 2010	39.0
Depreciation charge for the year	10.4
Disposals	(6.4)
Classified as held-for-sale	(0.5)
Effect of foreign currency exchange adjustment	(0.3)
At 31 December 2011	42.2
Depreciation charge for the period	4.9
Disposals	(1.9)
Effect of foreign currency exchange adjustment	0.8
At 30 June 2012	**46.0**
Net book amount	
At 30 June 2012	**85.3**
At 31 December 2011	**46.9**
At 31 December 2010	**52.6**
At 31 December 2009	**59.2**

18. INVESTMENT PROPERTY

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
At 1 January	69.5	83.5	77.8	88.6
Disposals	(69.5)	—	—	—
(Decrease) / increase in fair value	—	(14.0)	5.7	(10.8)
As at end of period	**—**	**69.5**	**83.5**	**77.8**

Investment property comprised freehold property occupied by RBS Group under operating leases. Such property was sold to The Royal Bank of Scotland plc on 28 June 2012. Both the terms of the original operating leases, and the property sale, were conducted on an arm's length basis. Valuations were carried out at 31 December 2011 by an independent valuer.

19. SUBSIDIARIES

The principal subsidiary undertakings of the Group are shown below. Their capital consists of ordinary shares which are unlisted.

Direct Line Versicherung AG, DL Insurance Services Limited (the company changed its name from RBS Insurance Services Limited to DL Insurance Services Limited on 10 September 2012) and U K Insurance Limited are owned directly by Direct Line Insurance Group plc, and Direct Line Insurance S.p.A is owned indirectly through intermediary holding companies. All subsidiaries are included in the Group's combined financial information and have an accounting reference date of 31 December.

Name of subsidiary	Place of incorporation and operation	Proportion of ownership interest (ordinary shares)	Proportion of voting power held	Principal activity
Direct Line Insurance S.p.A	Italy	Ordinary	100%	General insurance
Direct Line Versicherung AG . . .	Germany	Ordinary	100%	General insurance
DL Insurance Services Limited . .	Great Britain	Ordinary	100%	Management services
U K Insurance Limited	Great Britain	Ordinary	100%	General insurance

The above information is provided in relation to principal related undertakings as permitted by Section 410(2) of the Companies Act 2006. Full information on all related undertakings is included in the Annual Return available from Companies House.

The Group acquired 100% of the share capital of Direct Line Versicherung AG on 2 April 2012. The fair value of identifiable assets acquired was £368.7 million (including cash and cash equivalents of £39.7 million), and the fair value of identifiable liabilities assumed was £263.5 million. The total cash consideration paid was £105.2 million.

The Group disposed of no subsidiaries in the six months ended 30 June 2012 (profit on the sale of subsidiary undertakings for the year ended 31 December 2011: £1.6 million; 2010: £nil; 2009: £216.1 million).

The disposal in 2011 was in respect of Devitt Insurance Services Limited which was sold to CKH Limited for a consideration of £2.3 million. Cash and cash equivalents included in the disposal were £2.4 million along with other assets of £7.3 million and other liabilities of £9.0 million.

The disposal in 2009 was in respect of the Group's 50% shareholding in Linea Directa Aseguradora S.A which was sold to Bankinter S.A for a consideration of £380.9 million. Cash and cash equivalents included in the disposal were £50.0 million along with debt securities of £321.7 million, fixed assets of £19.7 million, other assets of £61.3 million, insurance liabilities of £263.2 million and other liabilities of £24.7 million.

20. REINSURANCE ASSETS

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Reinsurers' share of general insurance liabilities	930.7	712.8	611.8	457.3
General insurance impairment provision	(55.3)	(53.9)	(9.2)	(1.9)
Reinsurers' share of life insurance liabilities	88.8	82.7	58.3	62.2
Total assets arising from reinsurance contracts	**964.2**	**741.6**	**660.9**	**517.6**

20. REINSURANCE ASSETS (Continued)

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Analysis of movement in impairment provision				
At 1 January	(53.9)	(9.2)	(1.9)	(2.5)
Impairment loss recognised on reinsurance contracts	(1.4)	(44.8)	(8.0)	—
Impairment losses reversed	—	0.1	0.7	0.6
As at end of period	**(55.3)**	**(53.9)**	**(9.2)**	**(1.9)**

21. DEFERRED ACQUISITION COSTS

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
At 1 January	310.5	299.5	338.5	364.0
Net credit / (charge) to the income statement	26.6	11.0	(39.0)	(13.9)
Disposal of joint venture	—	—	—	(11.6)
As at end of period	**337.1**	**310.5**	**299.5**	**338.5**

22. INSURANCE AND OTHER RECEIVABLES

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Receivables arising from insurance and reinsurance contracts:				
Due from policyholders	1,008.8	988.9	1,212.3	1,413.5
Less provision for impairment of receivables from policyholders	(9.4)	(8.8)	(15.6)	(7.9)
Due from agents, brokers and intermediaries	157.4	176.9	281.9	197.6
Less provision for impairment of receivables from agents, brokers and intermediaries	(0.5)	(0.4)	(0.9)	(3.0)
Due from reinsurers:				
—third-party reinsurers	31.1	46.0	49.0	52.8
Other loans and receivables:				
Accrued interest	1.9	3.3	3.3	7.5
Receivables from related parties (note 39)	6.1	7.7	7.6	13.9
Other debtors	38.4	39.3	68.6	58.4
Total insurance and other receivables	**1,233.8**	**1,252.9**	**1,606.2**	**1,732.8**

23. DERIVATIVE FINANCIAL INSTRUMENTS

The Group enters into derivative financial instruments (derivatives) to manage balance sheet foreign exchange risk as per note 3.7.1. The table below analyses the Group's derivative position at the balance sheet date:

	30 June		31 December					
	2012 £ Million		2011 £ Million		2010 £ Million		2009 £ Million	
	Notional amounts	Fair value	Notional amounts	Fair value	Notional amounts	Fair value	Notional amounts	Fair value
Derivative assets								
At fair value through the income statement	1,008.3	15.3	—	—	—	—	—	—
Designated as hedging instruments	103.2	1.8	53.5	0.1	—	—	70.0	1.3
Total	**1,111.5**	**17.1**	**53.5**	**0.1**	**—**	**—**	**70.0**	**1.3**
Derivative liabilities								
At fair value through the income statement	205.9	0.4	—	—	—	—	—	—
Designated as hedging instruments	186.3	1.2	—	—	57.8	0.7	—	—
Total	**392.2**	**1.6**	**—**	**—**	**57.8**	**0.7**	**—**	**—**

Derivative financial instruments as shown above are all classified as level 2 under the fair value hierarchy. These are measured at fair value, which equates to carrying value.

24. FINANCIAL INVESTMENTS

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Available-for-sale investments				
Government bonds	2,947.1	3,481.2	3,031.5	1,686.0
Corporate bonds	3,916.4	3,843.2	3,968.6	4,607.0
Mortgage-backed securities	169.3	283.5	496.1	686.3
Available-for-sale investments	**7,032.8**	**7,607.9**	**7,496.2**	**6,979.3**

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Debt securities:				
Listed—fixed interest rate	6,457.9	6,747.8	6,451.4	5,219.2
Listed—floating interest rate	574.9	860.1	1,044.8	1,760.1
	7,032.8	7,607.9	7,496.2	6,979.3
Other investment funds:				
Other investment funds	—	382.8	370.9	367.3
Total available-for-sale investments	**7,032.8**	**7,990.7**	**7,867.1**	**7,346.6**

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Loans and receivables				
Deposits with credit institutions with maturities in excess of three months				
—third parties	283.0	1,342.6	821.4	981.3
—related parties (note 39)	200.0	147.0	142.0	420.0
Total loans and receivable deposits	**483.0**	**1,489.6**	**963.4**	**1,401.3**
Total financial investments	**7,515.8**	**9,480.3**	**8,830.5**	**8,747.9**

24. FINANCIAL INVESTMENTS (Continued)

Included within the debt securities balance as at 30 June 2012 is £233.7 million (31 December 2011: £304.6 million; 2010: £562.0 million; 2009: £824.0 million) relating to securities issued by members of RBS Group.

Other investment funds comprised an investment fund which included euro and US dollar denominated bonds, hedged back to sterling.

The following table shows an analysis of financial instruments recorded at fair value, which equates to its carrying value, by level of the fair value hierarchy:

At 30 June 2012

	Level 1 (note i) £ Million	Level 2 (note ii) £ Million	Total £ Million
Financial assets			
Available-for-sale financial assets			
Debt securities	2,242.1	4,790.7	7,032.8
Total	**2,242.1**	**4,790.7**	**7,032.8**

At 31 December 2011

	Level 1 (note i) £ Million	Level 2 (note ii) £ Million	Total £ Million
Financial assets			
Available-for-sale financial assets			
Debt securities	2,862.6	4,745.3	7,607.9
Other investment funds	—	382.8	382.8
Total	**2,862.6**	**5,128.1**	**7,990.7**

At 31 December 2010

	Level 1 (note i) £ Million	Level 2 (note ii) £ Million	Total £ Million
Financial assets			
Available-for-sale financial assets			
Debt securities	2,793.4	4,702.8	7,496.2
Other investment funds	—	370.9	370.9
Total	**2,793.4**	**5,073.7**	**7,867.1**

24. FINANCIAL INVESTMENTS (Continued)

At 31 December 2009

	Level 1 (note i) £ Million	Level 2 (note ii) £ Million	Total £ Million
Financial assets			
Available-for-sale financial assets			
Debt securities	1,270.2	5,709.1	6,979.3
Other investment funds	—	367.3	367.3
Total	**1,270.2**	**6,076.4**	**7,346.6**

Notes:

(i) Level 1 financial assets are measured in whole or in part by reference to published quotes in an active market. In an active market 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.

(ii) Included in the Level 2 category are financial assets measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions. These are assets for which pricing is obtained via pricing services, but where prices have not been determined in an active market, financial assets with fair values based on broker quotes, investments in private equity funds with fair values obtained via fund managers and assets that are valued using the Group's own models whereby the majority of assumptions are market observable.

(iii) The Group held no Level 3 securities at 30 June 2012, or 31 December 2011, 2010 and 2009.

25. CASH AND CASH EQUIVALENTS

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Cash at bank and in hand:				
—third parties	199.3	153.5	102.9	94.2
—related parties (note 39)	73.8	48.4	131.4	29.3
	273.1	201.9	234.3	123.5
Short-term deposits with credit institutions:				
—third parties*	2,244.9	1,029.5	1,526.5	978.1
—related parties (note 39)	47.6	148.4	80.6	158.7
	2,292.5	1,177.9	1,607.1	1,136.8
Total cash and cash equivalents	**2,565.6**	**1,379.8**	**1,841.4**	**1,260.3**

* Included in the above are investments held by the Group in Global Treasury Funds PLC, (an open-ended umbrella investment company with variable capital incorporated with limited liability in Ireland) as at 30 June 2012 £838.6 million (31 December 2011: £612.0 million; 31 December 2010: £602.6 million; 31 December 2009: £545.7 million). RBS Asset Management (Dublin) Limited is the appointed manager to the fund.

The effective interest rate on short-term deposits with credit institutions as at 30 June 2012 was 0.51% (31 December 2011: 0.78%; 2010: 0.61%; 2009: 1.20%) and has an average maturity as at 30 June 2012 of 21 days (31 December 2011: 85 days; 2010: 78 days; 2009: 57 days).

25. CASH AND CASH EQUIVALENTS (Continued)

For the purposes of the cash flow statement, cash and bank overdrafts are as follows:

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Cash and cash equivalents	2,565.6	1,379.8	1,841.4	1,260.3
Bank overdrafts (note 32)	(83.7)	(70.2)	(77.9)	(34.4)
Total	**2,481.9**	**1,309.6**	**1,763.5**	**1,225.9**

26. ASSETS HELD-FOR-SALE

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Freehold property held-for-sale	**1.0**	**1.0**	**—**	**—**

The Company intends to dispose of freehold property it no longer utilises at Lumbry Park, Alton. As at 30 June 2012 the property is actively being marketed, with no further impairment losses recognised in the period ended 30 June 2012.

27. INVESTED CAPITAL

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Authorised:				
Equity shares				
Ordinary shares of £1 each	**1,500.0**	**1,500.0**	**1,500.0**	**1,500.0**
Issued and fully paid:				
Equity shares				
Ordinary shares of £1 each				
At 1 January and end of period	**1,500.0**	**1,500.0**	**1,500.0**	**1,500.0**

28. OTHER RESERVES AND RETAINED EARNINGS

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Capital contribution reserve	100.0	100.0	100.0	100.0
Reserve for revaluation of available-for-sale investments	135.5	137.1	41.9	(20.8)
Non-distributable reserve	47.2	30.3	197.6	183.6
Foreign exchange translation reserve	4.9	6.4	5.4	5.3
Demerger reserve	326.0	301.4	245.5	143.3
Other reserves at end of period	**613.6**	**575.2**	**590.4**	**411.4**
Retained earnings at end of period	**792.1**	**1,537.6**	**1,133.2**	**1,410.7**
Non-controlling interest				
Undated loan capital	**258.5**	**258.5**	**258.5**	**258.5**

The undated loan capital of £258.5 million was provided by TPF in 2006. This is shown in the Group's capital as a perpetual subordinated loan and qualifies as tier two capital. There is no interest payable on this instrument.

28. OTHER RESERVES AND RETAINED EARNINGS (Continued)

Movements in the revaluation reserve for available-for-sale investments were as follows:

	Equity shares £ Million	Other investment funds £ Million	Debt securities £ Million	Total £ Million
At 1 January 2009	(43.7)	—	(120.4)	**(164.1)**
Revaluation during the period—gross	101.3	2.2	144.4	**247.9**
Revaluation during the period—tax	(28.9)	(0.6)	(33.9)	**(63.4)**
Recycled to profit or loss on disposal of subsidiaries	—	—	3.3	**3.3**
Realised gains—gross	(40.1)	—	(22.0)	**(62.1)**
Tax on realised gains	11.4	—	6.2	**17.6**
At 31 December 2009	—	**1.6**	**(22.4)**	**(20.8)**
Revaluation during the period—gross	—	3.3	130.3	**133.6**
Revaluation during the period—tax	—	(0.9)	(36.3)	**(37.2)**
Realised gains—gross	—	—	(46.8)	**(46.8)**
Tax on realised gains	—	—	13.1	**13.1**
At 31 December 2010	**—**	**4.0**	**37.9**	**41.9**
Revaluation during the period—gross	—	11.8	172.0	**183.8**
Revaluation during the period—tax	—	(3.1)	(47.3)	**(50.4)**
Realised gains—gross	—	—	(52.3)	**(52.3)**
Tax on realised gains	—	—	14.1	**14.1**
At 31 December 2011	**—**	**12.7**	**124.4**	**137.1**
Revaluation during the period—gross	—	6.3	56.2	**62.5**
Revaluation during the period—tax	—	(1.5)	(13.8)	**(15.3)**
Realised gains—gross	—	(23.2)	(41.5)	**(64.7)**
Tax on realised gains	—	5.7	10.2	**15.9**
At 30 June 2012	**—**	**—**	**135.5**	**135.5**

Movements in the non-distributable reserves were as follows:

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
At 1 January	30.3	197.6	183.6	158.3
Transfer from / (to) retained earnings for movement in period	16.9	(167.3)	14.0	25.3
At end of period	**47.2**	**30.3**	**197.6**	**183.6**

The non-distributable reserve relates to a UK statutory claims equalisation reserve that is calculated in accordance with the rules of the FSA. The transfer to retained earnings in 2011 was a consequence of the Group consolidation of its four UK general insurance underwriting entities by way of a FSMA Part VII transfer, which is a mechanism used to transfer all the insurance business, rights, benefits, obligations and interests into one insurance underwriter.

28. OTHER RESERVES AND RETAINED EARNINGS (Continued)

Movements in the foreign translation exchange reserve were as follows:

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
At 1 January	6.4	5.4	5.3	24.7
Disposal of subsidiary	—	—	—	(20.8)
Movement foreign currency translation adjustment	(1.5)	1.0	0.1	1.4
At end of period	**4.9**	**6.4**	**5.4**	**5.3**

Movements in the demerger reserve were as follows:

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
At 1 January	301.4	245.5	143.3	—
Costs recharged from RBS Group	24.6	55.9	102.2	143.3
At end of period	**326.0**	**301.4**	**245.5**	**143.3**

For an explanation of the nature of the demerger reserve, please refer to note 1.

29. SUBORDINATED LIABILITIES

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Subordinated dated notes	**516.1**	—	—	—

The subordinated dated notes were issued on 27 April 2012 at a fixed rate of 9.25%. The nominal £500 million bonds have a redemption date of 27 April 2042. The Group has the option to repay the notes on specific dates from 27 April 2022. If the notes are not repaid on that date, the rate of interest would be reset at a rate of the six-month LIBOR plus 7.91%.

The notes are unsecured, subordinated obligations of the Group, and rank *pari passu* without any preference among themselves. In the event of a winding up or of bankruptcy, they are to be repaid only after the claims of all other creditors have been met.

There have been no defaults on any of the notes during the period. The Group has the option to defer interest payments on the notes but to date has not exercised this right.

The aggregate fair value of subordinated dated notes as at 30 June 2012 is £515.9 million (31 December 2011, 2010, and 2009: £nil).

30. INSURANCE LIABILITIES, UNEARNED PREMIUM RESERVE AND REINSURANCE ASSETS

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Insurance liabilities				
Life insurance business (note 31)	102.2	97.8	74.2	86.7
General insurance business	6,412.4	6,411.2	6,867.2	5,841.8
Total insurance liabilities excluding unearned premiums	**6,514.6**	**6,509.0**	**6,941.4**	**5,928.5**
Gross (general insurance business)				
Claims reported	3,978.8	4,036.9	4,220.4	4,032.9
Claims incurred but not reported	2,273.9	2,217.5	2,514.2	1,675.4
Loss adjustment expenses	147.9	153.2	107.2	104.5
Liability adequacy provision	11.8	3.6	25.4	29.0
Total insurance liabilities, gross excluding unearned premiums	6,412.4	6,411.2	6,867.2	5,841.8
Unearned premiums	1,946.7	1,931.6	2,288.6	2,499.8
Total general insurance liabilities, gross	**8,359.1**	**8,342.8**	**9,155.8**	**8,341.6**
Recoverable from reinsurers (general insurance business)				
Claims reported	(371.8)	(318.1)	(310.0)	(326.6)
Claims incurred but not reported	(439.1)	(281.8)	(220.8)	(52.1)
Total recoverable from reinsurers, excluding unearned premiums	(810.9)	(599.9)	(530.8)	(378.7)
Unearned premiums	(64.5)	(59.0)	(71.8)	(76.7)
Total reinsurers' share of general insurance liabilities	**(875.4)**	**(658.9)**	**(602.6)**	**(455.4)**
Net (general insurance business)				
Claims reported	3,607.0	3,718.8	3,910.4	3,706.3
Claims incurred but not reported	1,834.8	1,935.7	2,293.4	1,623.3
Loss adjustment expenses	147.9	153.2	107.2	104.5
Liability adequacy provision	11.8	3.6	25.4	29.0
Total general insurance liabilities, net excluding unearned premiums	5,601.5	5,811.3	6,336.4	5,463.1
Unearned premiums	1,882.2	1,872.6	2,216.8	2,423.1
Total general insurance liabilities, net	**7,483.7**	**7,683.9**	**8,553.2**	**7,886.2**

30. INSURANCE LIABILITIES, UNEARNED PREMIUM RESERVE AND REINSURANCE ASSETS (Continued)

General insurance claims—gross
Accident year

	31 December									30 June	
	2003 £ Million	2004 £ Million	2005 £ Million	2006 £ Million	2007 £ Million	2008 £ Million	2009 £ Million	2010 £ Million	2011 £ Million	2012 £ Million	Total £ Million
Estimate of ultimate claims costs:											
At end of accident year*	3,648.5	3,679.1	4,007.5	4,091.6	4,390.5	3,878.1	4,148.0	4,261.9	3,080.5	**1,469.4**	**36,655.1**
One year later*	(135.6)	(187.2)	(175.8)	(266.1)	(62.0)	23.2	120.0	(98.1)	(32.2)	—	**(813.8)**
Two years later*	(105.5)	(89.8)	(141.7)	(42.0)	(1.1)	43.9	(42.5)	(26.4)	—	—	**(405.1)**
Three years later*	(62.1)	(61.3)	(57.9)	(17.6)	49.4	(38.3)	(29.8)	—	—	—	**(217.6)**
Four years later*	(42.9)	(41.9)	(59.5)	10.1	(7.0)	(20.0)	—	—	—	—	**(161.2)**
Five years later*	(19.7)	(15.2)	15.3	(21.6)	(14.3)	—	—	—	—	—	**(55.5)**
Six years later*	(25.3)	70.5	7.8	(8.3)	—	—	—	—	—	—	**44.7**
Seven years later*	19.5	12.8	1.9	—	—	—	—	—	—	—	**34.2**
Eight years later*	7.7	14.4	—	—	—	—	—	—	—	—	**22.1**
Nine years later*	(3.0)	—	—	—	—	—	—	—	—	—	**(3.0)**
Current estimate of cumulative claims	3,281.6	3,381.4	3,597.6	3,746.1	4,355.5	3,886.9	4,195.7	4,137.4	3,048.3	**1,469.4**	**35,099.9**
Cumulative payments to date	(3,153.3)	(3,166.7)	(3,421.7)	(3,466.9)	(3,918.3)	(3,353.2)	(3,323.6)	(3,034.7)	(1,809.2)	**(404.1)**	**(29,051.7)**
Liability recognised in balance sheet	128.3	214.7	175.9	279.2	437.2	533.7	872.1	1,102.7	1,239.1	**1,065.3**	**6,048.2**
Liability in respect of 2002 and previous periods											204.5
Loss adjustment expenses											147.9
Total gross liability included in the balance sheet											**6,400.6**

General insurance claims—net of reinsurance
Accident year

	31 December									30 June	
	2003 £ Million	2004 £ Million	2005 £ Million	2006 £ Million	2007 £ Million	2008 £ Million	2009 £ Million	2010 £ Million	2011 £ Million	2012 £ Million	Total £ Million
Estimate of ultimate claims costs:											
At end of accident year*	3,207.4	3,486.1	3,869.6	4,030.8	4,341.3	3,816.0	4,113.0	4,219.3	2,946.1	**1,352.8**	**35,382.4**
One year later*	(103.3)	(169.2)	(159.3)	(249.7)	(81.7)	24.1	70.0	(109.7)	(62.6)	—	**(841.4)**
Two years later*	(101.8)	(94.1)	(159.4)	(52.7)	(23.3)	8.2	(23.0)	(57.9)	—	—	**(504.0)**
Three years later*	(71.0)	(68.3)	(62.0)	(28.2)	17.7	(24.5)	(46.1)	—	—	—	**(282.4)**
Four years later*	(42.4)	(53.3)	(61.6)	9.9	(10.4)	(33.2)	—	—	—	—	**(191.0)**
Five years later*	(36.0)	(13.5)	7.2	(43.5)	(20.6)	—	—	—	—	—	**(106.4)**
Six years later*	(20.5)	60.7	(0.4)	(18.8)	—	—	—	—	—	—	**21.0**
Seven years later*	5.5	(4.1)	(5.4)	—	—	—	—	—	—	—	**(4.0)**
Eight years later*	6.2	(9.2)	—	—	—	—	—	—	—	—	**(3.0)**
Nine years later*	(9.1)	—	—	—	—	—	—	—	—	—	**(9.1)**
Current estimate of cumulative claims	2,835.0	3,135.1	3,428.7	3,647.8	4,223.0	3,790.6	4,113.9	4,051.7	2,883.5	**1,352.8**	**33,462.1**
Cumulative payments to date	(2,775.3)	(3,010.8)	(3,295.3)	(3,416.2)	(3,857.9)	(3,324.8)	(3,293.6)	(3,018.4)	(1,738.9)	**(385.2)**	**(28,116.4)**
Liability recognised in balance sheet	59.7	124.3	133.4	231.6	365.1	465.8	820.3	1,033.3	1,144.6	**967.6**	**5,345.7**
Liability in respect of 2002 and previous periods											96.1
Loss adjustment expenses											147.9
Total net liability											**5,589.7**

* The movement in the leading diagonal for each accident year relates to the six month period to 30 June 2012.

30. INSURANCE LIABILITIES, UNEARNED PREMIUM RESERVE AND REINSURANCE ASSETS (Continued)

Movements in general insurance liabilities and reinsurance assets

(i) Claims and loss adjustment expenses

	Gross £ Million	Reinsurance £ Million	Net £ Million
Notified claims	4,092.7	(314.4)	3,778.3
Incurred but not reported	1,426.8	(43.7)	1,383.1
At 1 January 2009	**5,519.5**	**(358.1)**	**5,161.4**
Cash paid for claims settled in the year	(3,810.0)	77.1	(3,732.9)
Increase / (decrease) in liabilities			
—arising from current-year claims	4,331.9	(44.3)	4,287.6
—arising from prior-year claims	(63.3)	(61.8)	(125.1)
Net exchange differences	(29.2)	1.5	(27.7)
Disposals	(136.1)	6.9	(129.2)
At 31 December 2009	**5,812.8**	**(378.7)**	**5,434.1**
Notified claims	4,137.4	(326.6)	3,810.8
Incurred but not reported	1,675.4	(52.1)	1,623.3
At 31 December 2009	**5,812.8**	**(378.7)**	**5,434.1**
Cash paid for claims settled in the year	(3,907.0)	153.4	(3,753.6)
Increase / (decrease) in liabilities			
—arising from current-year claims	4,453.4	(105.1)	4,348.3
—arising from prior-year claims	486.4	(201.4)	285.0
Net exchange differences	(3.8)	1.0	(2.8)
At 31 December 2010	**6,841.8**	**(530.8)**	**6,311.0**
Notified claims	4,327.6	(310.0)	4,017.6
Incurred but not reported	2,514.2	(220.8)	2,293.4
At 31 December 2010	**6,841.8**	**(530.8)**	**6,311.0**
Cash paid for claims settled in the year	(3,547.7)	81.7	(3,466.0)
Increase / (decrease) in liabilities			
—arising from current-year claims	3,345.3	(134.4)	3,210.9
—arising from prior-year claims	(209.9)	(17.2)	(227.1)
Net exchange differences	(21.9)	0.8	(21.1)
At 31 December 2011	**6,407.6**	**(599.9)**	**5,807.7**
Notified claims	4,190.1	(318.1)	3,872.0
Incurred but not reported	2,217.5	(281.8)	1,935.7
At 31 December 2011	**6,407.6**	**(599.9)**	**5,807.7**
Cash paid for claims settled in the period	(1,474.8)	56.8	(1,418.0)
Increase / (decrease) in liabilities			
—arising from current-year claims	1,589.9	(116.6)	1,473.3
—arising from prior-year claims	(104.4)	(154.0)	(258.4)
Net exchange differences	(17.7)	2.8	(14.9)
At 30 June 2012	**6,400.6**	**(810.9)**	**5,589.7**
Notified claims	4,126.7	(371.8)	3,754.9
Incurred but not reported	2,273.9	(439.1)	1,834.8
At 30 June 2012	**6,400.6**	**(810.9)**	**5,589.7**

30. INSURANCE LIABILITIES, UNEARNED PREMIUM RESERVE AND REINSURANCE ASSETS (Continued)

(ii) (Decrease) / Increase in net liabilities arising from prior-year claims

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Motor	(108.5)	(138.2)	398.1	95.5
Home	(29.2)	48.5	(69.0)	(42.1)
Rescue and other personal lines	(12.7)	(52.8)	(38.5)	(24.9)
Commercial	(58.5)	(38.4)	(60.3)	(54.4)
International	(19.5)	(7.9)	(43.6)	(55.5)
Total Ongoing	**(228.4)**	**(188.8)**	**186.7**	**(81.4)**
Run-off	(30.0)	(38.3)	98.3	(43.7)
Total Group	**(258.4)**	**(227.1)**	**285.0**	**(125.1)**

(iii) Provisions for unearned premiums

	Gross £ Million	Reinsurance £ Million	Net £ Million
Unearned premium reserve			
At 1 January 2009	**2,710.9**	**(79.2)**	**2,631.7**
Net decrease in the year	(39.3)	2.5	(36.8)
Exchange movement	(14.3)	—	(14.3)
Disposal of joint venture	(157.5)	—	(157.5)
At 31 December 2009	**2,499.8**	**(76.7)**	**2,423.1**
Net decrease in the year	(181.4)	(4.6)	(186.0)
Exchange movement	(19.9)	(0.4)	(20.3)
Reclassification	(9.9)	9.9	—
At 31 December 2010	**2,288.6**	**(71.8)**	**2,216.8**
Net decrease in the year	(354.6)	12.8	(341.8)
Exchange movement	(2.4)	—	(2.4)
At 31 December 2011	**1,931.6**	**(59.0)**	**1,872.6**
Net increase in the period	27.7	(5.6)	22.1
Exchange movement	(12.6)	0.1	(12.5)
At 30 June 2012	**1,946.7**	**(64.5)**	**1,882.2**

30. INSURANCE LIABILITIES, UNEARNED PREMIUM RESERVE AND REINSURANCE ASSETS (Continued)

(iv) Provisions for liability adequacy provision

	£ Million
Liability adequacy provision	
At 1 January 2009	**4.9**
Increase in the year	24.1
At 31 December 2009	**29.0**
Decrease in the year	(3.6)
At 31 December 2010	**25.4**
Decrease in the year	(21.8)
At 31 December 2011	**3.6**
Increase in the period	8.2
At 30 June 2012	**11.8**

31. LIFE INSURANCE CONTRACTS AND REINSURANCE ASSETS

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Gross				
Long-term insurance contracts:				
—with fixed and guaranteed terms	96.4	93.0	68.4	82.2
—benefits outstanding	5.8	4.8	5.8	4.5
Total life insurance liabilities, gross	**102.2**	**97.8**	**74.2**	**86.7**
Recoverable from reinsurers				
Long-term insurance contracts				
—with fixed and guaranteed terms	(83.9)	(78.6)	(53.3)	(58.3)
—benefits outstanding	(4.9)	(4.1)	(5.0)	(3.9)
Total reinsurers' share of life insurance liabilities	**(88.8)**	**(82.7)**	**(58.3)**	**(62.2)**
Net				
Long-term insurance contracts				
—with fixed and guaranteed terms	12.5	14.4	15.1	23.9
—benefits outstanding	0.9	0.7	0.8	0.6
Total life insurance liabilities, net	**13.4**	**15.1**	**15.9**	**24.5**

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Current	5.0	5.8	6.4	10.2
Non-current	8.4	9.3	9.5	14.3
Total	**13.4**	**15.1**	**15.9**	**24.5**

31. LIFE INSURANCE CONTRACTS AND REINSURANCE ASSETS (Continued)

Movements in life insurance liabilities and reinsurance assets

	Gross £ Million	Reinsurance £ Million	Net £ Million
At 1 January 2009	**95.4**	**(58.3)**	**37.1**
Provisions in respect of new and existing business	51.2	(24.9)	26.3
Expected change in existing business provisions	(9.0)	13.3	4.3
Variance between actual and expected experience	(40.6)	11.6	(29.0)
Other movements	(14.8)	—	(14.8)
At 31 December 2009	**82.2**	**(58.3)**	**23.9**
Provisions in respect of new and existing business	49.7	(26.3)	23.4
Expected change in existing business provisions	(15.2)	16.9	1.7
Variance between actual and expected experience	(35.7)	14.4	(21.3)
Other movements	(12.6)	—	(12.6)
At 31 December 2010	**68.4**	**(53.3)**	**15.1**
Provisions in respect of new and existing business	45.9	(25.4)	20.5
Expected change in existing business provisions	(21.7)	16.2	(5.5)
Variance between actual and expected experience	8.7	(16.1)	(7.4)
Other movements	(8.3)	—	(8.3)
At 31 December 2011	**93.0**	**(78.6)**	**14.4**
Provisions in respect of new and existing business	22.5	(12.6)	9.9
Expected change in existing business provisions	(10.0)	9.2	(0.8)
Variance between actual and expected experience	(3.8)	(1.9)	(5.7)
Other movements	(5.3)	—	(5.3)
At 30 June 2012	**96.4**	**(83.9)**	**12.5**

32. BORROWINGS

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Loans from related parties (note 39)	—	247.7	249.2	250.8
Bank overdrafts with related parties (note 39)	83.7	64.2	77.9	34.4
Bank overdrafts with third parties	—	6.0	—	—
Total borrowings	**83.7**	**317.9**	**327.1**	**285.2**
On demand or within one year	83.7	71.5	296.0	253.2
One to five years	—	205.0	—	—
Six to ten years	—	11.3	—	—
After ten years	—	30.1	31.1	32.0
Total borrowings	**83.7**	**317.9**	**327.1**	**285.2**

The carrying value of borrowings approximates to their fair value.

33. RETIREMENT BENEFITS OBLIGATIONS

Defined contribution scheme

DL Insurance Services Limited ("**DLISL**") operates the Group pension scheme which was established in 1988. The contributions paid by DLISL are charged to the income statement, as incurred.

33. RETIREMENT BENEFITS OBLIGATIONS (Continued)

The pension charge in respect of the defined contribution scheme for the six months ended 30 June 2012 was £15.0 million (six months ended 30 June 2011 (unaudited): £15.0 million; years ended 31 December 2011: £28.0 million; 2010: £35.8 million; 2009: £36.9 million).

In addition, certain employees of the Group who were previously members of the RBS Group defined benefit pension scheme, transferred to the Group's defined contribution scheme in the period. As a result of standardising employment terms for all Group employees, which included changes to the employment terms of a small portion of Group employees, who were members of the RBS Group defined benefit pension scheme, the Group crystallised a debt under section 75 of the UK Pensions Act 1995. Consequently the Group was required to pay into the RBS Group's defined benefit pension scheme (in which those employees ceased to participate) as a result of a deficit in that scheme. The debt was calculated based on the amount needed to secure the Group's share of the pension liabilities in the pension scheme with an insurance company. An amount of £31.3 million was paid to the RBS Group pension scheme on 29 June 2012 in full and final settlement.

Defined benefit scheme

The Group's defined benefit pension scheme was closed in 2003 although DLISL remains the sponsoring employer for obligations to current and deferred pensioners.

The assumptions in respect of the defined benefit scheme and the amounts accounted for under IAS 19 are set out below.

	Six months ended 30 June	Year ended 31 December		
	2012 %	2011 %	2010 %	2009 %
Rate of increase in pension payment	1.9	2.1	2.7	3.5
Rates of increase of deferred pensions	1.9	2.1	2.7	3.5
Discount rate	4.6	5.0	5.5	5.9
Inflation rate	2.8	3.0	3.3	3.5

No assumption has been made for salary growth as there are no liabilities in the scheme that are linked to future increases in salaries.

The assets in the Scheme and the expected rates of return are included in the table below together with the present value of the obligations and deficit in the Scheme.

	30 June 2012		31 December 2011		31 December 2010		31 December 2009	
	Expected return %	Value £ Million	Expected return %	Value £ Million	Expected return %	Value £ Million	Expected return %	2009 £ Million
Equities	7.7	38.4	7.7	34.5	7.7	35.7	8.0	32.9
Index-linked bonds	3.1	7.2	3.1	7.2	4.2	6.0	4.5	4.6
Government bonds	3.1	7.2	3.1	7.2	4.2	6.0	4.5	4.6
Corporate bonds	4.7	7.2	4.7	7.2	5.5	6.0	5.9	4.4
Other	5.0	0.6	5.0	0.6	5.5	0.7	6.4	0.7
Total market value of assets		**60.6**		**56.7**		**54.4**		**47.2**
Present value of fund obligations		58.1		54.1		54.5		60.8
Surplus / (deficit) in the Scheme		2.5		2.6		(0.1)		(13.6)
Deferred tax asset at 25% (2011: 25%, 2010 and 2009: 28%)		**0.6**		**0.6**		**0.0**		**(3.8)**

33. RETIREMENT BENEFITS OBLIGATIONS (Continued)

The expected return on scheme assets reflects the average rate of earnings expected on the investments made to provide the pension benefit obligations that are secured by the pension scheme. The starting point for setting the expected return was the nominal gross redemption yield on UK gilt-edged securities at the balance sheet date. The expected yield as at 30 June 2012 is 3.1% a year, which is based on the methodology used to set the assumptions at 31 December 2011 (31 December 2011: 3.1%; 2010: 4.2%; 2009: 4.5%). The expected return on corporate bonds was set equal to the discount rate which implies a risk premium over government bonds as at 30 June 2012 of 1.6% (31 December 2011: 1.6%; 2010: 1.3%; 2009: 1.4%) a year. For equities it has been assumed that they will outperform government bonds as at 30 June 2012 by 4.6% (31 December 2011: 4.6%; 2010: 3.5%; 2009: 3.5%) a year.

The deferred tax asset has been netted off against the net pension liability and has been accounted for as a liability (note 13).

Amounts credited / (charged) to the income statement

	Six months ended 30 June	Year ended 31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Interest on obligation	(1.4)	(3.0)	(3.5)	(2.9)
Expected return on plan assets	1.8	3.7	3.4	2.8
	0.4	**0.7**	**(0.1)**	**(0.1)**

The credit / (charge) to the income statement has been included under other operating expenses.

Amounts charged / (credited) to the statement of comprehensive income

	Six months ended 30 June	Year ended 31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Actual return on scheme assets	(2.0)	(1.1)	(6.4)	(8.2)
less: expected return on scheme assets	1.8	3.7	3.4	2.8
Experience (gain) / loss on scheme assets	**(0.2)**	**2.6**	**(3.0)**	**(5.4)**
Experience gain on scheme liabilities	(0.4)	(0.4)	(0.4)	(2.6)
Changes in assumptions underlying the present value of scheme liabilities	3.6	(1.6)	(7.5)	16.6
Actuarial loss / (gain)	**3.0**	**0.6**	**(10.9)**	**8.6**

Changes in the present value of the defined benefit obligation are as follows:

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Opening defined benefit obligation	54.1	54.5	60.8	45.3
Interest cost	1.4	3.0	3.5	2.9
Actuarial losses / (gains)	3.2	(2.1)	(7.8)	14.0
Benefits paid	(0.6)	(1.3)	(2.0)	(1.4)
Closing defined benefit obligation	**58.1**	**54.1**	**54.5**	**60.8**

33. RETIREMENT BENEFITS OBLIGATIONS (Continued)

Changes in the fair value of the plan assets are as follows:

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Opening fair value of plan assets	56.7	54.4	47.2	37.5
Expected return	1.8	3.7	3.3	2.8
Actuarial gains / (loss)	0.2	(2.6)	3.1	5.4
Contributions	2.5	2.5	2.8	2.9
Benefits paid	(0.6)	(1.3)	(2.0)	(1.4)
Closing fair value of plan assets	**60.6**	**56.7**	**54.4**	**47.2**
Net pension surplus / (deficit) before deferred tax:				
brought forward	2.6	(0.1)	(13.6)	(7.8)
carried forward	**2.5**	**2.6**	**(0.1)**	**(13.6)**

The history of the plan for the current and prior years is as follows:

	30 June	31 December				
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million	2008 £ Million	2007 £ Million
Present value of defined benefit obligation	(58.1)	(54.1)	(54.5)	(60.8)	(45.3)	(53.6)
Fair value of plan assets	60.6	56.7	54.4	47.2	37.5	43.3
Surplus / (deficit)	**2.5**	**2.6**	**(0.1)**	**(13.6)**	**(7.8)**	**(10.3)**
Experience adjustments on plan liabilities	(0.4)	(0.4)	(0.5)	(2.6)	(0.7)	1.0
Experience adjustments on plan assets	(0.2)	2.6	(3.1)	(5.4)	(10.7)	(0.3)

Sensitivity analysis

The results of sensitivity testing are set out below. The impact of a reasonably possible change in a single factor is shown, with other assumptions left unchanged.

Sensitivity factor	
Discount rate	The impact of a change in the principal actuarial assumptions on the discount rate for the present value of pension scheme obligations. This sensitivity analysis has been selected to reflect the changes to cash flows as a result of changes to the discount rate. The methodology adopted involves actuarial techniques.
Inflation rate	The impact of a change in the principal actuarial assumptions on the inflation rate for the present value of pension scheme obligations. This sensitivity analysis has been selected to reflect the changes to the general level of prices of goods and services over time. The methodology adopted involves actuarial techniques.

33. RETIREMENT BENEFITS OBLIGATIONS (Continued)

Sensitivity at 30 June 2012

	Discount rate +0.25%	Discount rate −0.25%	Inflation rate +0.25%	Inflation rate −0.25%
Impact on profit before tax (£ Million)	—	—	—	—
Impact before tax on total equity (£ Million)	(2.6)	2.6	2.5	(2.4)

Sensitivity at 31 December 2011

	Discount rate +0.25%	Discount rate −0.25%	Inflation rate +0.25%	Inflation rate −0.25%
Impact on profit before tax (£ Million)	—	—	—	—
Impact before tax on total equity (£ Million)	(2.6)	2.6	2.5	(2.4)

Sensitivity at 31 December 2010

	Discount rate +0.25%	Discount rate −0.25%	Inflation rate +0.25%	Inflation rate −0.25%
Impact on profit before tax (£ Million)	—	—	—	—
Impact before tax on total equity (£ Million)	(2.6)	2.6	2.6	(2.5)

Sensitivity at 31 December 2009

	Discount rate +0.25%	Discount rate −0.25%	Inflation rate +0.25%	Inflation rate −0.25%
Impact on profit before tax (£ Million)	—	—	—	—
Impact before tax on total equity (£ Million)	(3.1)	3.2	3.2	(3.0)

The most recent funding valuation of the defined benefit scheme took place as at 1 October 2011. The Group has agreed to make contributions of £2.8 million per annum from 2013 to 2016 for the future accrual of benefits, and does not anticipate any material change to the level of funding before the next valuation, which is due on 1 October 2014.

34. TRADE AND OTHER PAYABLES INCLUDING INSURANCE PAYABLES

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Provisions:				
Regulatory levies and other provisions				
At 1 January	77.6	99.5	111.9	102.7
Charged to the income statement:				
—additional provisions	18.4	39.0	72.9	102.7
Disposal of subsidiary	—	—	—	(4.7)
Used during period	(24.8)	(60.9)	(85.3)	(88.8)
At end of period	**71.2**	**77.6**	**99.5**	**111.9**

Other provisions consist of provisions that arise in the ordinary course of business.

34. TRADE AND OTHER PAYABLES INCLUDING INSURANCE PAYABLES (Continued)

Trade and other payables, including insurance payables:

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Due to agents, brokers and intermediaries	6.2	4.8	10.9	25.8
Due to reinsurers	77.8	66.1	69.4	86.6
Due to insurance companies	10.5	5.4	6.0	11.4
Due to insurance partners	26.9	—	5.4	32.5
Due to related parties (note 39)	75.9	158.7	44.7	27.9
Trade creditors and accruals	223.2	212.2	140.8	165.8
Other creditors	131.1	287.6	239.4	246.4
Other taxes	103.3	86.5	69.7	71.2
Provisions	71.2	77.6	99.5	111.9
Deferred income	11.1	11.3	12.2	21.5
Total trade and other payables including insurance payables	**737.2**	**910.2**	**698.0**	**801.0**

On 2 April 2012, the Company acquired Direct Line Versicherung AG. In the preparation of this combined financial information for previous reporting periods, a liability for the payment to RBS Group for the transfer of ownership and control was recognised. This liability was settled in April 2012 but was previously re-measured at each period end with changes recognised in the combined statement of changes in equity. Included within other creditors as at 30 June 2012 is an amount of £nil (31 December 2011: £110.9 million; 2010: £101.3 million; 2009: £108.4 million) in respect of an inter-company creditor with RBS Group.

35. NOTES TO THE COMBINED CASH FLOW STATEMENT

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
		(unaudited)			
Profit / (loss) for the period	82.8	142.2	249.0	(271.9)	133.1
Adjustments for:					
Investment revenues	(110.2)	(125.5)	(249.0)	(266.2)	(314.3)
Instalment income	(62.1)	(76.7)	(145.0)	(187.7)	(155.9)
Other operating (income) / loss	(1.1)	1.4	12.4	39.8	1.6
Net fair value gains / (losses) on assets at fair value through income	—	—	14.0	(5.7)	14.4
Finance costs	10.2	1.4	2.7	2.5	4.4
Tax charge / (credit)	23.7	45.3	93.9	(106.2)	(0.9)
Depreciation and amortisation expenses	19.3	12.5	31.5	29.6	32.5
Non-cash movement in demerger reserve	24.6	35.7	55.9	102.2	143.3
Impairment of property, plant and equipment, goodwill and intangible assets	—	—	18.9	12.0	69.5
Impairment losses on financial investments	—	—	2.0	21.4	8.3
Impairment losses on reinsurance contracts	1.4	—	44.7	7.4	(0.6)
Profit on sale of available-for-sale financial investments	(64.7)	(21.3)	(52.9)	(37.1)	(73.9)
Loss on sale of property, plant and equipment	2.8	—	0.2	—	0.6
Profit on disposal of joint venture	—	(1.6)	(1.6)	—	(216.1)
Operating cash flows before movements in working capital	**(73.3)**	**13.4**	**76.7**	**(659.9)**	**(354.0)**
Movements in working capital					
Net (decrease) / increase in net insurance liabilities	(204.5)	(370.8)	(885.4)	546.0	361.9
Net decrease / (increase) in prepayments and accrued income and other assets	30.5	33.1	36.9	(31.5)	(9.1)
Net decrease in insurance and other receivables	15.9	198.5	238.4	231.8	32.8
Net (increase) / decrease in derivative financial instruments	(14.3)	(2.1)	(0.4)	0.4	(0.2)
Net (decrease) / increase in trade and other payables including insurance payables	(164.1)	(34.0)	158.3	(55.7)	5.6
Increase in cash contribution to retirement obligation	(2.5)	(2.5)	(2.5)	(2.8)	(2.8)
Cash (used by) / generated from operations	**(412.3)**	**(164.4)**	**(378.0)**	**28.3**	**34.2**
Taxes received / (paid)	—	—	20.7	63.4	(209.4)
Interest paid	(2.0)	(1.4)	(2.5)	(2.5)	(2.9)
Net cash flow (used by) / generated from operating activities before investment of insurance assets	**(414.3)**	**(165.8)**	**(359.8)**	**89.2**	**(178.1)**
Interest received	156.8	193.2	440.8	467.7	506.0
Rental income received from investment properties	3.5	3.6	7.1	7.3	8.4
Proceeds on disposal of investment properties	69.5	—	—	—	—
Dividends received from equity shares	—	—	—	—	13.8
Distributions received from other investment funds	3.1	3.7	8.5	10.2	3.9
Proceeds on disposal/maturity of available-for-sale financial assets	2,253.1	3,413.9	6,403.4	3,448.3	2,318.6
Net decrease / (increase) in investment balances held with credit institutions	1,006.6	(396.7)	(422.9)	438.0	2,284.5
Purchases of available-for-sale investments	(1,252.7)	(3,891.6)	(6,398.1)	(3,885.5)	(4,259.5)
Cash generated from / (used by) investment of insurance assets	**2,239.9**	**(673.9)**	**38.8**	**486.0**	**875.7**

Since the publication of the debt prospectus in April 2012, the Group has revised the classification of certain items between operating activities before investment of insurance assets and financing activities. The combined cash flow statements for prior periods have been revised to reflect this change. However,

35. NOTES TO THE COMBINED CASH FLOW STATEMENT (Continued)

this has not resulted in a change to the movements of cash and cash equivalents at the end of the relevant periods.

36. CONTINGENCIES AND GUARANTEES

The Group did not have any contingent liabilities.

Companies within the Group have guaranteed the performance of certain contracts with insurance partners. There was a guarantee in place from 1 June 2011 until 31 January 2012 of £70 million for events occurring up to 31 January 2012, although liability under this guarantee was reduced at 31 January 2012 to £58.5 million for events occurring after that date. There are further guarantees in place which also relate to contracts with insurance partners for £90.3 million as at 30 June 2012.

37. COMMITMENTS

Operating lease commitments

The Group leases vehicles under non-cancellable operating lease agreements.

The Group also leases vehicles and other assets under cancellable operating lease agreements.

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Minimum lease payments under operating leases recognised as an expense in the period	**4.9**	**5.2**	**7.4**	**7.5**	**8.8**

At the balance sheet date, the Group had outstanding commitments under non-cancellable operating leases, which fall due as follows:

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Within one year	8.6	8.7	9.2	9.8
In the second to fifth years inclusive	16.2	19.0	18.7	21.3
After five years	8.0	9.3	10.6	12.1
Total commitments	**32.8**	**37.0**	**38.5**	**43.2**

38. CLASSIFICATION OF FINANCIAL INSTRUMENTS

The following table analyses the Group's financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39. Non-financial assets and liabilities outside the scope of IAS 39 are shown separately. Other than those financial assets and liabilities stated at fair value below, the carrying value of all other financial assets and liabilities equals their fair value.

38. CLASSIFICATION OF FINANCIAL INSTRUMENTS (Continued)

At 30 June 2012

	Assets/ liabilities at fair value £ Million	Available-for-sale £ Million	Loans and receivables £ Million	Other (amortised costs) £ Million	Non-financial assets/liabilities £ Million	Total £ Million
Assets						
Goodwill and other intangible assets	—	—	—	—	390.9	390.9
Property, plant and equipment	—	—	—	—	85.3	85.3
Reinsurance assets	—	—	—	—	964.2	964.2
Deferred tax assets	—	—	—	—	31.0	31.0
Current tax assets	—	—	—	—	4.4	4.4
Deferred acquisition costs	—	—	—	—	337.1	337.1
Insurance and other receivables	—	—	1,233.8	—	—	1,233.8
Prepayments, accrued income and other assets	—	—	—	—	61.6	61.6
Derivative financial instruments	17.1	—	—	—	—	17.1
Retirement benefit asset	—	—	—	—	2.5	2.5
Financial investments	—	7,032.8	483.0	—	—	7,515.8
Cash and cash equivalents	—	—	2,565.6	—	—	2,565.6
Assets held-for-sale	—	—	—	—	1.0	1.0
	17.1	**7,032.8**	**4,282.4**	**—**	**1,878.0**	**13,210.3**
Liabilities						
Subordinated liabilities	—	—	—	516.1	—	516.1
Insurance liabilities	—	—	—	—	6,514.6	6,514.6
Unearned premium reserve	—	—	—	—	1,946.7	1,946.7
Borrowings	—	—	—	83.7	—	83.7
Derivative financial instruments	1.6	—	—	—	—	1.6
Trade and other payables including insurance payables	—	—	—	666.0	71.2	737.2
Deferred tax liabilities	—	—	—	—	15.1	15.1
Current tax liabilities	—	—	—	—	231.1	231.1
	1.6	**—**	**—**	**1,265.8**	**8,778.7**	**10,046.1**
Total equity						3,164.2
						13,210.3

38. CLASSIFICATION OF FINANCIAL INSTRUMENTS (Continued)

At 31 December 2011

	Assets/ liabilities at fair value £ Million	Available-for-sale £ Million	Loans and receivables £ Million	Other (amortised costs) £ Million	Non-financial assets/liabilities £ Million	Total £ Million
Assets						
Goodwill and other intangible assets	—	—	—	—	365.8	365.8
Property, plant and equipment	—	—	—	—	46.9	46.9
Investment property	—	—	—	—	69.5	69.5
Reinsurance assets	—	—	—	—	741.6	741.6
Deferred tax assets	—	—	—	—	26.9	26.9
Deferred acquisition costs	—	—	—	—	310.5	310.5
Insurance and other receivables	—	—	1,252.9	—	—	1,252.9
Prepayments, accrued income and other assets	—	—	—	—	92.2	92.2
Derivative financial instruments	0.1	—	—	—	—	0.1
Retirement benefit asset	—	—	—	—	2.6	2.6
Financial investments	—	7,990.7	1,489.6	—	—	9,480.3
Cash and cash equivalents	—	—	1,379.8	—	—	1,379.8
Assets held-for-sale	—	—	—	—	1.0	1.0
	0.1	**7,990.7**	**4,122.3**	**—**	**1,657.0**	**13,770.1**
Liabilities						
Insurance liabilities	—	—	—	—	6,509.0	6,509.0
Unearned premium reserve	—	—	—	—	1,931.6	1,931.6
Borrowings	—	—	—	317.9	—	317.9
Trade and other payables including insurance payables	—	—	—	832.6	77.6	910.2
Deferred tax liabilities	—	—	—	—	12.1	12.1
Current tax liabilities	—	—	—	—	218.0	218.0
	—	**—**	**—**	**1,150.5**	**8,748.3**	**9,898.8**
Total equity						3,871.3
						13,770.1

38. CLASSIFICATION OF FINANCIAL INSTRUMENTS (Continued)

At 31 December 2010

	Assets/ liabilities at fair value £ Million	Available-for-sale £ Million	Loans and receivables £ Million	Other (amortised costs) £ Million	Non-financial assets/liabilities £ Million	Total £ Million
Assets						
Goodwill and other intangible assets	—	—	—	—	286.1	286.1
Property, plant and equipment	—	—	—	—	52.6	52.6
Investment property	—	—	—	—	83.5	83.5
Reinsurance assets	—	—	—	—	660.9	660.9
Deferred tax assets	—	—	—	—	17.0	17.0
Current tax assets	—	—	—	—	25.9	25.9
Deferred acquisition costs	—	—	—	—	299.5	299.5
Insurance and other receivables	—	—	1,606.2	—	—	1,606.2
Prepayments, accrued income and other assets	—	—	—	—	113.3	113.3
Financial investments	—	7,867.1	963.4	—	—	8,830.5
Cash and cash equivalents	—	—	1,841.4	—	—	1,841.4
	—	**7,867.1**	**4,411.0**	**—**	**1,538.8**	**13,816.9**
Liabilities						
Insurance liabilities	—	—	—	—	6,941.4	6,941.4
Unearned premium reserve	—	—	—	—	2,288.6	2,288.6
Borrowings	—	—	—	327.1	—	327.1
Derivative financial instruments	0.7	—	—	—	—	0.7
Retirement benefit obligations	—	—	—	—	0.1	0.1
Trade and other payables including insurance payables	—	—	—	598.5	99.5	698.0
Deferred tax liabilities	—	—	—	—	76.3	76.3
Current tax liabilities	—	—	—	—	2.6	2.6
	0.7	**—**	**—**	**925.6**	**9,408.5**	**10,334.8**
Total equity						3,482.1
						13,816.9

38. CLASSIFICATION OF FINANCIAL INSTRUMENTS (Continued)

At 31 December 2009

	Assets/ liabilities at fair value £ Million	Available-for-sale £ Million	Loans and receivables £ Million	Other (amortised costs) £ Million	Non-financial assets/liabilities £ Million	Total £ Million
Assets						
Goodwill and other intangible assets	—	—	—	—	290.3	290.3
Property, plant and equipment	—	—	—	—	59.2	59.2
Investment property	—	—	—	—	77.8	77.8
Reinsurance assets	—	—	—	—	517.6	517.6
Deferred tax assets	—	—	—	—	17.1	17.1
Current tax assets	—	—	—	—	50.8	50.8
Deferred acquisition costs	—	—	—	—	338.5	338.5
Insurance and other receivables	—	—	1,732.8	—	—	1,732.8
Prepayments, accrued income and other assets	—	—	—	—	92.2	92.2
Derivative financial instruments	1.3	—	—	—	—	1.3
Financial investments	—	7,346.6	1,401.3	—	—	8,747.9
Cash and cash equivalents	—	—	1,260.3	—	—	1,260.3
	1.3	**7,346.6**	**4,394.4**	**—**	**1,443.5**	**13,185.8**
Liabilities						
Insurance liabilities	—	—	—	—	5,928.5	5,928.5
Unearned premium reserve	—	—	—	—	2,499.8	2,499.8
Borrowings	—	—	—	285.2	—	285.2
Retirement benefit obligations	—	—	—	—	13.6	13.6
Trade and other payables including insurance payables	—	—	—	689.1	111.9	801.0
Deferred tax liabilities	—	—	—	—	76.8	76.8
Current tax liabilities	—	—	—	—	0.3	0.3
	—	**—**	**—**	**974.3**	**8,630.9**	**9,605.2**
Total equity						3,580.6
						13,185.8

39. RELATED PARTIES

On 1 December 2008, the UK Government through HM Treasury became the ultimate controlling party of The Royal Bank of Scotland Group plc. The UK Government's shareholding is managed by UK Financial Investments Limited, a company wholly owned by the UK Government. This gives rise to related party transactions and balances, specifically in respect of tax with HMRC and debt security investments with the UK Government.

The Group's ultimate and immediate holding company is The Royal Bank of Scotland Group plc which is incorporated in the United Kingdom and registered in Scotland.

As at 30 June 2012, The Royal Bank of Scotland Group plc heads the largest group in which the Group is consolidated. Copies of the consolidated accounts of The Royal Bank of Scotland Group plc may be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh EH12 1HQ.

The following transactions were carried out with related parties, who are all members of RBS Group.

39. RELATED PARTIES (Continued)

i. Sales of insurance contracts and other services

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Parent	(0.1)	(0.4)	—	—	—
Fellow subsidiaries	5.9	10.0	17.6	14.6	45.9
Total	**5.8**	**9.6**	**17.6**	**14.6**	**45.9**

ii. Purchases of services

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Parent	151.4	138.4	287.9	329.3	380.8
Fellow subsidiaries	21.9	7.8	63.9	87.7	41.4
Total	**173.3**	**146.2**	**351.8**	**417.0**	**422.2**

Purchases of services are charged on an arm's length basis.

Employee costs recharged by RBS Group include the full costs of key managers and other staff in respect of share-based payments. The attribution among members of the RBS Group has regard to the needs of the RBS Group as a whole.

iii. Compensation of key management

The aggregate remuneration of directors and other members of key management during the period was as follows:

	Six months ended 30 June		Year ended 31 December		
	2012 £ Million	2011 £ Million (unaudited)	2011 £ Million	2010 £ Million	2009 £ Million
Fees as directors	0.1	0.1	0.1	0.1	0.1
Other emoluments	4.5	3.5	6.2	3.3	2.1
Company pension contributions	0.4	0.3	0.6	0.4	0.3
Compensation for loss of office	0.1	—	—	—	—
Total	**5.1**	**3.9**	**6.9**	**3.8**	**2.5**

39. RELATED PARTIES (Continued)

iv. Period-end balances arising from cash and investment transactions with members of the RBS Group

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Cash at bank held with related parties (note 25)	73.8	48.4	131.4	29.3
Short-term bank deposits held with related parties (note 25)	47.6	148.4	80.6	158.7
Bank overdrafts held with related parties (note 32)	(83.7)	(64.2)	(77.9)	(34.4)
Term deposits held with related parties (note 24)	200.0	147.0	142.0	420.0
Total	**237.7**	**279.6**	**276.1**	**573.6**

Debt securities held with related parties (note 24)

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
RBS Group issuers	**233.7**	**304.6**	**562.0**	**824.0**

v. Period-end balances arising from sales/purchases of products/services.

Receivables from related parties (note 22)

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Parent	0.1	0.1	—	—
Fellow Subsidiaries	6.0	7.6	7.6	13.9
Total	**6.1**	**7.7**	**7.6**	**13.9**

Movements in receivables from related parties were as follows:

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
At 1 January	7.7	7.6	13.9	51.9
Transactions in the period	67.9	7.3	9.3	45.1
Settled in the period	(69.5)	(7.2)	(15.6)	(83.1)
At the end of period	**6.1**	**7.7**	**7.6**	**13.9**

Included in the above is an amount of £69.5 million in the period ended 30 June 2012, invoiced to and paid by The Royal Bank of Scotland plc for the purchase of investment properties.

Due to related parties (note 34)

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Parent	56.0	75.1	10.7	24.4
Fellow Subsidiaries	19.9	83.6	34.0	3.5
Total	**75.9**	**158.7**	**44.7**	**27.9**

39. RELATED PARTIES (Continued)

Movements due to related parties were as follows:

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
At 1 January	158.7	44.7	27.9	29.4
Transactions in the period	179.7	261.0	266.8	232.7
Settled in the period	(262.5)	(147.0)	(250.0)	(234.2)
At end of period	**75.9**	**158.7**	**44.7**	**27.9**

Included in the above is an amount of £39.3 million in the period ended 30 June 2012, invoiced by and paid to the Royal Bank of Scotland plc for the acquisition of furniture, fittings and IT hardware. Furthermore, also included is an amount of £31.3 million paid to the RBS group pension scheme, see note 1.17 for further details.

vi. Loans from related parties (note 32)

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
Parent	—	12.5	13.0	13.9
Fellow Subsidiary	—	235.2	236.2	236.9
Total	**—**	**247.7**	**249.2**	**250.8**

Movements in loans to related parties were as follows:

	30 June	31 December		
	2012 £ Million	2011 £ Million	2010 £ Million	2009 £ Million
At 1 January	247.7	249.2	250.8	254.0
Loans received during the year	—	205.0	—	—
Loan repayments made	(246.4)	(205.5)	(0.9)	(0.8)
Interest charged (note 11)	2.7	2.3	2.2	3.8
Interest settled	(2.7)	(2.3)	(2.2)	(3.8)
Exchange movements	(1.3)	(1.0)	(0.7)	(2.4)
At end of period	**—**	**247.7**	**249.2**	**250.8**

During the half year ended 30 June 2012, the Group repaid its loans from RBS Group in preparation for operational separation from RBS Group.

40. POST BALANCE SHEET EVENTS

On 31 August 2012, board and shareholder resolutions were approved to subdivide the share capital of Direct Line Insurance Group plc from 1.5 billion ordinary shares of £1 each to 1.5 billion ordinary shares of 10 pence each and 1.5 billion deferred shares of 90 pence each. The deferred shares were then transferred back to the Company by its parent, The Royal Bank of Scotland Group plc, for no value and immediately cancelled by the Company. This cancellation has created a non-distributable capital redemption reserve in the Company of £1,350.0 million. The Company's issued share capital now comprises 1.5 billion ordinary shares of 10 pence each, all held legally and beneficially by The Royal Bank of Scotland Group plc. For the period ended 30 June 2012, this would not have altered the earnings per share calculation.

40. POST BALANCE SHEET EVENTS (Continued)

The Company declared and paid a further interim dividend of £200 million to The Royal Bank of Scotland Group plc on 3 September 2012. This represents the final dividend prior to the Offer.

On 26 September 2012, the Group confirmed to TPF its intention, subject to FSA consent, to repay the £258.5 million of undated loan capital, currently reported within non-controlling interest, at a date to be determined, being 10 days within the later of the date of FSA consent and 31 December 2012.

Section A—Unaudited pro-forma financial information

The unaudited pro-forma income statement and balance sheet as at 31 December 2011 have been prepared to show the effect of certain capital actions undertaken in 2012 as if these had happened on 31 December 2011. It has been prepared for illustrative purposes only in accordance with Annex II of the Prospectus Directive Regulation and should be read in conjunction with the notes set out below. Because of its nature, it addresses a hypothetical situation and therefore does not represent the Group's actual return on equity for the six months ended 30 June 2012, nor its financial position as at 31 December 2011.

Income statement for the six months ended 30 June 2012

	Six months ended 30 Jun 2012	Adjustment: Interest on Subordinated liabilities	Unaudited Pro-forma
	£ million Note 1	£ million Note 2	£ million
Gross earned premium	2,034.7	—	2,034.7
Reinsurance premium ceded	(164.5)	—	(164.5)
Net earned premium	**1,870.2**	**—**	**1,870.2**
Investment return	176.0	—	176.0
Instalment income and other operating income	99.1	—	99.1
Total income	**2,145.3**	**—**	**2,145.3**
Insurance claims	(1,509.1)	—	(1,509.1)
Insurance claims recoverable from reinsurers	285.0	—	285.0
Net insurance claims	**(1,224.1)**	**—**	**(1,224.1)**
Commission expenses	(222.0)	—	(222.0)
Other operating expenses	(582.5)	—	(582.5)
	(804.5)	**—**	**(804.5)**
Operating profit	**116.7**	**—**	**116.7**
Finance costs	(10.2)	(15.8)	(26.0)
Profit before tax	**106.5**	**(15.8)**	**90.7**
Tax (charge) credit	(23.7)	3.9	(19.8)
Profit for the period	**82.8**	**(11.9)**	**70.9**

Balance sheet as at 31 December 2011 and as at 30 June 2012

	As at 31 Dec 11	Adjustments: Issue of Subordinated Liabilities	Adjustments: Dividends paid	Unaudited pro-forma	As at 30 Jun 12
	£ million Note 1	£ million Note 2	£ million Note 3		£ million Note 1
ASSETS					
Goodwill and other intangible assets	365.8	—	—	365.8	390.9
Financial investments	9,480.3	—	—	9,480.3	7,515.8
Cash and cash equivalents	1,379.8	500.0	(800.0)	1,079.8	2,565.6
Other assets	2,544.2	—	—	2,544.2	2,738.0
Total assets	**13,770.1**	500.0	(800.0)	**13,470.1**	**13,210.3**
EQUITY					
Total invested equity	3,612.8	—	(800.0)	2,812.8	2,905.7
Non-controlling interest	258.5	—	—	258.5	258.5
Total equity	**3,871.3**	—	(800.0)	**3,071.3**	**3,164.2**
LIABILITIES					
Total liabilities	**9,898.8**	**500.0**	**—**	**10,398.8**	**10,046.1**
Total equity and liabilities	**13,770.1**	500.0	(800.0)	**13,470.1**	**13,210.3**

Notes

(1) The income statement for the six months ended 30 June 2012 and the balance sheets as at 31 December 2011 and as at 30 June 2012 are all extracted, without material adjustment, from the historical financial information set out in Part XIII: "*Financial Information*".

(2) The Group issued £500 million of subordinated notes, on 27 April 2012, at a fixed rate of interest of 9.25%. The adjustments, which have a continuing effect, show the issue of the Notes and the associated additional interest charge, net of taxation.

The additional interest charge is calculated at a rate of 9.25% on the £500 million subordinated loan notes for the six months ended 30 June 2012, which amounts to £23.2 million, less the actual interest charge on the subordinated loans for the six months ended 30 June 2012, of £7.4 million (see note 11 of the historical financial information set out in Part XIII: "*Financial Information*"), giving a net increase in finance costs of £15.8 million.

The taxation credit applicable to the additional interest charge, of £15.8 million, is calculated by applying at the Group's standard rate of tax for the six months ended 30 June 2012, of 24.5% (see note 12 of the historical financial information set out in Part XIII: "*Financial Information*"), resulting in a tax credit of £3.9 million. The net overall impact of these adjustments is to reduce profit after tax by £11.9 million.

(3) The Group paid a dividend of £300 million on 27 March 2012 and a dividend of £500 million on 6 June 2012.

(4) Pro forma return from ongoing operations on tangible invested equity for the six months ended 30 June 2012 is calculated as the adjusted profit, of £149.7 million divided by the average pro forma tangible invested equity of £2,480.9 million, and is quoted on an annualised basis. The calculations of adjusted profit and average pro-forma tangible invested equity are shown below.

Adjusted profit is calculated as follows:

	Six months ended 30 June 2012
	£ million
Profit before tax, as reported	106.5
Adjusted for:	
Operating profit of run-off activities	(1.2)
Restructuring and other one-off costs	108.7
Profit before tax from ongoing operations	214.0
Tax on profit from ongoing operations	(52.4)
Adjustment for interest on subordinated liabilities (net of tax). See Note 2	(11.9)
Adjusted profit from ongoing operations	**149.7**

Operating profit of run-off activities, and restructuring and other one-off costs, for the six months ended 30 June 2012 are both extracted, without material adjustment, from note 4 of the historical financial information set out in Part XIII: "*Financial Information*". Tax on profit from ongoing operations, of £52.4 million, is calculated by applying the Group's standard rate of tax for the six months ended 30 June 2012, of 24.5% (see note 12 of the historical financial information set out in Part XIII: "*Financial Information*") to the profit before tax from ongoing operations, of £214.0 million.

Average pro-forma tangible invested equity represents the mean of tangible invested equity as at 31 December 2011 and as at 30 June 2012, as follows:

	As at 31 Dec 2011		As at 30 June 2012
	£ million		£ million
Total invested equity	2,812.8		2,905.7
Less:			
Goodwill and other intangible assets	(365.8)		(390.9)
Tangible invested equity	2,447.0		2,514.8
Average pro-forma tangible invested equity		**2,480.9**	
Pro-forma return from ongoing operations on tangible invested equity for the six months ended 30 June 2012			6.0%
Annualised pro-forma return from ongoing operations on tangible invested equity for the six months ended 30 June 2012			**12.1%**

The annualised pro-forma return from ongoing operations on tangible invested equity for the six months ended 30 June 2012 has been calculated by doubling the pro-forma return from ongoing operations on tangible invested equity for the six months ended 30 June 2012. No account therefore has been taken of any seasonality in the Group's business.

Report on Pro-forma financial information

Deloitte.

Athene Place
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EC4A 3BQ

The Board of Directors
on behalf of Direct Line Insurance Group plc
Churchill Court
Westmoreland Road
Bromley
BR1 1DP

Goldman Sachs International
Peterborough Court
133 Fleet Street
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EC4V 5ER

Morgan Stanley & Co. International plc
25 Cabot Square
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E14 4QA

28 September 2012

Direct Line Insurance Group plc (the "Company")

We report on the pro forma financial information (the "Pro forma financial information") set out in Part XIV of the prospectus dated 28 September 2012 (the "Prospectus"), which has been prepared on the basis described, for illustrative purposes only, to provide information about how the transaction might have affected the financial information presented on the basis of the accounting policies adopted by the Company in preparing the financial statements for the period ended 30 June 2012. This report is required by Annex I item 20.2 of Commission Regulation (EC) No 809/2004 (the "Prospectus Directive Regulation") and is given for the purpose of complying with that requirement and for no other purpose.

Responsibilities

It is the responsibility of the directors of the Company (the "Directors") to prepare the Pro forma financial information in accordance with Annex I item 20.2 and Annex II items 1 to 6 of the Prospectus Directive Regulation.

It is our responsibility to form an opinion, in accordance with Annex I item 20.2 of the Prospectus Directive Regulation, as to the proper compilation of the Pro forma financial information and to report that opinion to you in accordance with Annex II item 7 of the Prospectus Directive Regulation.

Save for any responsibility arising under Prospectus Rule 5.5.3R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in accordance with this report or our statement, required by and given solely for the purposes of complying with Annex I item 23.1 of the Prospectus Directive Regulation, consenting to its inclusion in the Prospectus.

In providing this opinion we are not updating or refreshing any reports or opinions previously made by us on any financial information used in the compilation of the Pro forma financial information, nor do we accept responsibility for such reports or opinions beyond that owed to those to whom those reports or opinions were addressed by us at the dates of their issue.

Basis of Opinion

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. The work that we performed for the purpose of making this report, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the Pro forma financial information with the Directors.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Pro forma financial information has been properly compiled on the basis stated and that such basis is consistent with the accounting policies of the Company.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in jurisdictions outside the United Kingdom, including the United States of America, and accordingly should not be relied upon as if it had been carried out in accordance with those standards or practices.

Opinion

In our opinion:

(a) the Pro forma financial information has been properly compiled on the basis stated; and

(b) such basis is consistent with the accounting policies of the Company.

Declaration

For the purposes of Prospectus Rule 5.5.3R(2)(f)we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with Annex I item 1.2 of the Prospectus Directive Regulation.

Yours faithfully

Deloitte LLP
Chartered Accountants

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Deloitte LLP is the United Kingdom member firm of Deloitte Touche Tohmatsu Limited (“DTTL”), a UK private company limited by guarantee, whose member firms are legally separate and independent entities. Please see www.deloitte.co.uk/about for a detailed description of the legal structure of DTTL and its member firms.

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28 September 2012

The Board of Directors
Direct Line Insurance Group plc
Churchill Court
Westmoreland Road
Bromley
BR1 1DP

Dear Sirs

Independent External Actuaries' Statement

Introduction

At your request, Towers Watson Limited trading as Towers Watson ("we" or "Towers Watson") has undertaken an independent actuarial review of certain outstanding claims provisions, loss adjustment expense provisions, additional unexpired risk reserves (referred to by Direct Line Insurance Group plc as Liability Adequacy Provision) and reinsurance bad debt provisions of Direct Line Insurance Group plc ("you" or "DLG") as at 30 June 2012. Our review has been undertaken in connection with the proposed offering of ordinary shares of DLG and the admission to listing in the premium segment of the Official List maintained by the FSA and to trading on the London Stock Exchange.

This report, which has been produced for inclusion in the Prospectus issued by DLG dated 28 September 2012, sets out the scope of the work we have undertaken and summarises the conclusions of our work.

Save for any responsibility arising under Prospectus Rule 5.5.3R(2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in accordance with this report or our statement, required by and given solely for the purposes of complying with Annex I item 23.1 of the Prospectus Directive Regulation, consenting to its inclusion in the Prospectus.

Our opinion based on this review is set out below.

Scope of Work

This opinion addresses the net of outwards reinsurance claims provisions of DLG as at 30 June 2012 in respect of periods to 30 June 2012, and the corresponding provisions in respect of the requirement for loss adjustment expenses, additional unexpired risk reserves and reinsurance bad debt.

The scope of our opinion is restricted to DLG's general insurance business in the UK, Germany and Italy.

Our independent actuarial review covers more than 98.5% of DLG's total booked consolidated non-life reserves for net of outwards reinsurance outstanding claims, loss adjustment expenses, additional unexpired risk reserves and reinsurance bad debt. Within this total, our review covers the non-life reserves in relation to the Tesco Personal Finance ("TPF") business in the UK. The non-reviewed reserves include some of the smaller classes and reserves for older accident periods. We set out in Appendix A a detailed list of the classes of business within the scope of our independent actuarial review and those classes not independently reviewed by us.

A review of the premium reserves, reserves for future commissions, the need for any reinstatement premiums for reinsurance and any other technical provisions were outside the scope of our work and this opinion. Additionally, a review of any potential liabilities in relation to the mis-selling of Creditor (or Payment Protection Insurance) policies was outside the scope of our work and this opinion.

Reserves and provisions are calculated on an undiscounted basis with the exception of Periodical Payment Order claims on the UK motor account and the calculations in respect of the provision for additional unexpired risk reserves, consistent with UK financial reporting standards.

Opinion

Based on the scope of work set out above, and subject to the reliances and limitations set out below, we report our conclusions as follows:

DLG establishes its provision for total general insurance liabilities including a provision for adverse reserve movement over and above its best estimate of future liabilities. Including this provision for adverse reserve movement, in respect of periods to 30 June 2012, DLG held a net of outwards reinsurance outstanding claims provision together with provisions in respect of the requirement for loss adjustment expenses, additional unexpired risk reserves and reinsurance bad debt, together totalling £5,601.5 as at 30 June 2012.

In our opinion, DLG's overall outstanding claims provision on a net of outwards reinsurance basis and reinsurance bad debt (referred to by DLG in the aggregate as "Claims reported" and "Claims incurred but not reported") together with provisions in respect of the requirement for loss adjustment expenses and additional unexpired risk reserves (the latter referred to by DLG as "Liability Adequacy Provision") held at 30 June 2012 in respect of periods to 30 June 2012 (totalling £5,601.5 million, and referred to in the aggregate by DLG as "Total general insurance liabilities") exceed our corresponding estimate by 7.1% of our estimate.

Reliances and Limitations

In our work, we have relied on audited and unaudited information and data supplied to us by DLG, including information given orally and on information from a range of other sources. We relied on the accuracy and completeness of this information without independent verification. In particular, reliance was placed on, but not limited to, the accuracy of levels of earned premiums and provisions, claim payments and provisions, terms of reinsurance arrangements, and basic data records regarding the above. While we understand that DLG regularly reconciles movements in actuarial data to the DLG general ledger, complete records of reinsurance recoveries paid to date were not available for all classes, and so, as agreed with DLG, for certain classes of business we have used our own estimates for estimating the outstanding claims provisions on a net of outwards reinsurance basis.

In light of the UK flood event occurring in the last week of June 2012, we have received additional specific estimates of the ultimate cost of this event from DLG which we have reviewed and relied upon in our projections. We have also relied on the accuracy and completeness of the information supplied to us by DLG in respect of the impact of the quota share cover included in the reinsurance treaty for Direct Line Versicherung AG without independent verification, and, in particular, reliance was placed on the calculated reinsurance recoveries under the treaty for this specific cover.

The results shown in this report are based on a series of assumptions regarding the future. It should be recognised that actual future claim experience is likely to deviate, perhaps materially, from our estimates. This is because the ultimate liability for claims will be affected by future external events; for example, the likelihood of claimants bringing suit, the size of judicial awards, changes in standards of liability, and the attitudes of claimants towards the settlement of their claims. We have employed appropriate techniques and assumptions, and the conclusions presented in this opinion are reasonable, given the information currently available.

We have not anticipated any extraordinary changes to the legal, social, inflationary or economic environment, or to the interpretation of policy language, that might affect the cost, frequency, or future reporting of claims. In addition, our estimates make no provision for potential future claims arising from causes not substantially recognised in the historical data (such as new types of mass torts, latent injuries or pandemic events), except in so far as claims of these types are included incidentally in the reported claims and are implicitly developed.

The estimates are in Sterling based on the exchange rate of £1 = €1.2379 as at 30 June 2012, and as provided by DLG. A proportion of the liabilities is denominated in foreign currencies. To the extent that the assets backing the reserves are not held in matching currencies, future changes in exchange rates may lead to exchange gains or losses.

We have not attempted to determine the quality of the current asset portfolio of DLG, and we have assumed throughout our analysis that DLG's claims reserves are backed by valid assets with suitably scheduled maturities and/or adequate liquidity to meet cash flow requirements.

We have not reviewed the adequacy of the balance sheet provisions except as otherwise disclosed herein.

It has been assumed for the purposes of this opinion that all of DLG's reinsurance protection will be valid and collectable, although we have included in this opinion a reinsurance bad debt provision as at 30 June 2012 in respect of known issues on outstanding reinsurance recoveries and future reinsurance bad debt relating to reinsurer inability to pay.

The scope of our analysis does not include comment on capital requirements. In particular we have not investigated the level of capital required to protect DLG from adverse claims experience.

The results shown in this report are not intended to represent an opinion of market value and should not be interpreted in that manner. This report does not purport to encompass all of the many factors that may bear upon a market value.

Our analysis of the liabilities was carried out based on data and documentation that was made available to us as at 30 June 2012. While we have considered some elements of the actual experience in the period to 9 July 2012 in respect of the June 2012 UK flood event when deriving our opinion as at 30 June 2012, our analysis does not consider other development or information that became available after this date and our results, opinions and conclusions presented herein may be rendered inaccurate by developments after 30 June 2012.

Declaration

For the purposes of Prospectus Rule 5.5.3R(2)(f), we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with Annex I item 1.2 of the Prospectus Directive Regulation.

Yours sincerely

Karl P Murphy MA FIA FSAI
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Towers Watson

Anju Bell MA FIA
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Towers Watson

Appendix A

The following classes of business are **in scope** of the independent actuarial review underlying our opinion:

Business historically underwritten by **Direct Line Insurance Limited** in the UK (and subsequently transferred to **U K Insurance Limited**):

- Retail Private Motor
- Privilege Private Motor
- Retail Household
- Privilege Household
- Creditor
- Family Legal Protection
- Travel
- Pet
- DL4B Commercial Vans
- DL4B Commercial Property
- DL4B Pecuniary Loss
- DL4B Personal Accident
- DL4B General Liability

Business historically underwritten by **Churchill Insurance Company Limited** in the UK (and subsequently partially transferred to **U K Insurance Limited**):

- Retail Private Motor
- Partnerships Private Motor
- Broker Private Motor
- Retail Household
- Partnerships Household
- Family Legal Protection

Business historically underwritten by **U K Insurance Limited** in the UK prior to the Part VII transfer:

- Private Motor
- Household
- Creditor
- Family Legal Protection
- Travel
- Pet

Business historically underwritten by **The National Insurance and Guarantee Corporation Ltd** in the UK (and subsequently transferred to **U K Insurance Limited**):

- Private Motor
- Motorcycle
- Commercial Motor
- Domestic Property
- Commercial Property
- Pecuniary Loss

- Personal Accident
- General Liability

Business underwritten by **Direct Line Versicherung AG** in Germany:

- Motor Third Party Liability
- Motor Own Damage—Full Coverage
- Motor Own Damage—Partial Coverage

Business underwritten by **Direct Line Italia S.p.A.** in Italy:

- Motor business covered by the Lambrate, SIRI, Fiat and Fleet accounts

The following classes of business are **out of scope** of the independent actuarial review underlying our opinion:

Business historically underwritten by **Direct Line Insurance plc** in the UK (and subsequently transferred to **U K Insurance Limited**):

- Home Response (HR24)
- Assistance Rescue
- Creditor
- Home Emergency 24 Part VII Transfer
- Other minor classes, including Legal Motor, Enhanced Courtesy Car and Mid and High Net Worth Private Insurance

Business historically underwritten by **Churchill Insurance Company Limited** in the UK (and subsequently transferred to **U K Insurance Limited**):

- Assistance Rescue
- Prudential Assumed business, including Legal Home
- Pearl Assumed business, including Legal Home
- Household Broker business
- Motorcycle
- Legal Motor
- Travel
- Pet
- Home Emergency 24
- Other minor classes

Business historically underwritten by **U K Insurance Limited** in the UK prior to the Part VII transfer:

- Assistance Rescue and Home Response
- Legal Home
- Pet (non TPF)
- Special Risks
- Ulster Bank Home
- First Active
- Certain Creditor classes
- Home Emergency 24
- Income Protection
- Other minor classes

Business historically underwritten by **The National Insurance and Guarantee Corporation** Ltd in the UK (and subsequently transferred to **U K Insurance Limited**):

- Special risks
- Hallmark
- Towergate
- Endsleigh Private Motor
- Hill House Hammond
- NIG Avon
- Pearl Liability
- Legal Motor
- Creditor
- Travel
- Pet

Business underwritten by **Direct Line Versicherung AG** in Germany:

- Non-Motor
- Motorcycles
- Passenger Accident

Business underwritten by **Direct Line Italia S.p.A.** in Italy:

- Household

1. Incorporation and Registered Office

1.1 The Company was incorporated under the name Arjon Limited on 26 July 1988. On 3 February 2012, the Company was re-registered as a plc and changed its name to Direct Line Insurance Group plc.

1.2 The registered office and head office of the Company is at Churchill Court, Westmoreland Road, Bromley BR1 1DP, United Kingdom (telephone number +44 (0) 208 313 5810).

1.3 The principal legislation under which the Company operates and under which the Ordinary Shares were created, is the Companies Act.

2. Share Capital

2.1 The issued and fully paid share capital of the Company as at the date of publication of this Prospectus and immediately following Admission is as follows:

	Number	Amount
Ordinary Shares of 10p each	1,500 million	£150 million

2.2 The Company was incorporated with an issued share capital of £1,000 divided into 1,000 ordinary shares of £1 each, which were issued to the subscribers to the Company's articles of incorporation.

2.3 On 1 January 2009 (being the date of the commencement of the period for which historical financial information has been provided in this Prospectus), the issued share capital of the Company was £1,500 million divided into 1,500 million ordinary shares of £1 each, which were issued fully paid.

2.4 By a resolution of the Company passed on 31 August 2012 each of the 1,500,000,000 issued ordinary shares of £1 each in the capital of the Company was sub-divided into:

(a) 1,500,000,000 Ordinary Shares; and

(b) 1,500,000,000 deferred shares of 90 pence each.

2.5 Immediately following the passing of the resolution in paragraph 2.4 above, such deferred shares were acquired by the Company otherwise than for valuable consideration in accordance with section 659(1) of the Companies Act and cancelled by the Company in accordance with section 662(1)(c) of the Companies Act.

2.6 By a resolution of the Company passed on 21 September 2012 conditional on Admission becoming effective:

(a) the Directors were generally authorised, in accordance with section 551 of the Companies Act, to exercise all powers of the Company to allot shares in the Company or grant rights to subscribe for, or convert any security into, shares in the Company, this authority being limited to:

(i) the allotment of shares in the Company or the grant of rights to subscribe for, or convert any security into, shares in the Company up to an aggregate nominal amount of £50,000,000; and

(ii) comprising equity securities (as defined in section 560 of the Companies Act) up to a maximum nominal amount of £100,000,000 (including within such limit any shares allotted or rights granted under paragraph (i) above) in connection with an offer by way of a rights issue:

(A) to holders of Ordinary Shares in proportion (as nearly as may be practicable) to their existing holdings; and

(B) to holders of other equity securities if this is required by the rights of those securities or, if the Directors consider it necessary, as permitted by the rights of those securities;

and so that the Directors may make such exclusions or other arrangements as they consider expedient in relation to treasury shares, fractional entitlements, record dates, shares represented by depositary receipts, legal or practical problems under the laws in any territory or the requirements of any relevant regulatory body or stock exchange or any other matter;

and such authority to expire at the conclusion of the next annual general meeting of the Company after the passing of this resolution or, if earlier, 30 June 2013; and

(b) the Directors were given power to allot equity securities (as defined in section 560 of the Companies Act) for cash pursuant to the authority referred to in sub paragraph (a) above under section 551 of the Companies Act and to allot equity securities (as defined in section 560(3) of the Companies Act, in either case as if section 561 of that Act did not apply to the allotment, but this power, which expires at the conclusion of the next annual general meeting of the Company after the passing of this resolution or, if earlier, at the close of business on 30 June 2013, was limited to:

(i) the allotment of equity securities in connection with an offer or issue in favour of:

(A) holders of ordinary shares on the register in proportion (as nearly as practicable) to their existing holdings;

(B) holders of equity securities if this is required by the rights of those securities or, if the Directors consider it necessary, as permitted by the rights of those securities,

and so that the Directors may make such exclusions or other arrangements as they consider expedient in relation to treasury shares, fractional entitlements, record dates, shares represented by depositary receipts, legal or practical problems under the laws in any territory or the requirements of any regulatory body or stock exchange or any other matter; and

(ii) the allotment of equity securities pursuant to the authority granted under sub paragraph (a) above and/or by virtue of section 560(3) of the Act (in each case otherwise than pursuant to subparagraph (i) above) up to a maximum nominal amount of £7,500,000.

2.7 Section 561 of the Companies Act confers on shareholders certain rights of pre-emption in respect of the allotment of equity securities which are, or are to be, paid up in cash other than by way of allotment to employees under an employee's share scheme as defined in section 1166 of the Companies Act. Following Admission, the Company will be subject to the continuing obligations of the FSA's Listing Rules with regard to the issue of securities for cash and the statutory rights of pre-emption in section 561 of the Act. The statutory rights of pre-emption apply to the issue of new shares of the Company which is not the subject of the disapplication referred to in paragraph 2.6(b) above or reserved for issue in connection with share options and schemes (and other arrangements). The statutory rights of pre-emption have been disapplied as set out in paragraph 2.6 to:

(a) give the Directors flexibility in relation to a rights issue or open offer; and

(b) permit the Directors to allot Ordinary Shares for cash following the Offer having a nominal value of up to 5% of the issued ordinary share capital following Admission.

2.8 No new Ordinary Shares will be issued, allotted or offered in connection with the Offer or Admission.

2.9 Save as disclosed in this Prospectus:

(a) no share or loan capital of the Company or any of its subsidiaries has within the period covered by the historical financial information set out in this Prospectus (other than intra-group issues by wholly owned subsidiaries or pursuant to the Offer) been issued or been agreed to be issued fully or partly paid, either for cash or for a consideration other than cash and no such issue is now proposed;

(b) no commissions, discounts, brokerages or other special terms have been granted by the Company or any of its subsidiaries within the period covered by the historical financial information set out in this Prospectus in connection with the issue or sale of any share or loan capital of any such company; and

(c) no share or loan capital of the Company or any of its subsidiaries is under option or agreed, conditionally or unconditionally, to be put under option.

2.10 The Ordinary Shares are in registered form and, subject to the provisions of the CREST Regulations, the Directors may permit the holding of shares in any class of shares in uncertificated form and title to such shares may be transferred by means of a relevant system (as defined in the CREST Regulations). Where shares are held in certificated form, share certificates will be sent to the registered members by first class post.

2.11 When admitted to trading, the Ordinary Shares will be registered with the International Security Identification Number (ISIN) GB00B89W0M42 and SEDOL number B89W0M4.

3. Summary of the Company's Articles of Association

The articles of association of the Company adopted on 21 September 2012, conditional upon Admission becoming effective include provisions to the following effect:

3.1 Objects

The objects of the Company, in accordance with section 31(1) of the Act, are unrestricted.

3.2 Limited liability

The liability of the members is limited to the amount, if any, unpaid on the shares in the Company respectively held by them.

3.3 Rights attaching to shares

(a) Voting rights of members—subject to the articles of association and to any special rights or restrictions as to voting for the time being attached to any shares (as to which there are none at present) the provisions of the Companies Act shall apply in relation to voting rights. On a show of hands, every member or authorised corporate representative present has one vote and every proxy present has one vote except if the proxy has been duly appointed by more than one member and has been instructed by (or exercises his discretion given by) one or more of those members to vote for the resolution and has been instructed by (or exercises his discretion given by) one or more other of those members to vote against it, in which case a proxy has one vote for and one vote against the resolution. On a poll, every member present in person or by proxy has one vote for every share of which he is a holder. In the case of joint holders, the vote of the person whose name stands first in the register of members and who tenders a vote is accepted to the exclusion of any votes tendered by any other joint holders.

(b) Dividends—subject to the rights attached to any shares issued on any special terms and conditions (as to which there are none at present), dividends shall be declared and paid according to the amounts paid up on the shares in respect of which the dividend is paid, but no amount paid up on a share in advance of calls should be treated for these purposes as paid up on the share.

(c) Return of capital—if the Company is in liquidation, the liquidator may, with the sanction of a special resolution of the Company and any other authority required by any applicable statutory provision (A) divide among the members in specie the whole or any part of the assets of the Company; or (B) vest the whole or any part of the assets in trustees on such trusts for the benefit of members as the liquidator shall think fit, but no member shall be compelled to accept any assets upon which there is any liability.

(d) Capitalisation of reserves—the Board may, with the authority of an ordinary resolution of the Company: (A) resolve to capitalise any sum standing to the credit of any reserve account of the Company (including share premium account and capital redemption reserve) or any sum standing to the credit of profit and loss account not required for the payment of any preferential dividend (whether or not it is available for distribution); and (B) appropriate that sum as capital to the holders of shares in proportion to the nominal amount of the share capital held by them respectively and apply that sum on their behalf in paying up in full any shares or debentures of the Company of a nominal amount equal to that sum and allot the shares or debentures credited as fully paid to those members, or as they may direct, in those proportions or in paying up the whole or part of any amounts which are unpaid in respect of any issued shares in the Company held by them respectively, or otherwise deal with such sum as directed by the resolution provided that the share premium account and the capital redemption reserve, any redenomination reserve and any sum not available for distribution in accordance with the Statutes may only be applied in paying up shares to be allotted credited as fully paid up.

3.4 Transfer of shares

A member may transfer all or any of his shares in any manner which is permitted by any applicable statutory provision and is from time to time approved by the Board. The Company shall maintain a record of uncertificated shares in accordance with the relevant statutory provisions.

A member may transfer all or any of his certificated shares by an instrument of transfer in any usual form, or in such other form as the Board may approve. The instrument of transfer shall be signed by or on behalf of the transferor and, except in the case of a fully paid share, by or on behalf of the transferee. The Board may, in its absolute discretion, refuse to register any instrument of transfer of any certificated share which is not fully paid up (but not so as to prevent dealings in listed shares from taking place on an open and proper basis) or on which the Company has a lien. The Board may also refuse to register any instrument of transfer of a certificated share unless it is left at the registered office, or such other place as the Board may decide, for registration, accompanied by the certificate for the shares to be transferred and such other evidence (if any) as the Board may reasonably require to prove title of the intending transferor or his right to transfer shares; and it is in respect of only one class of shares. If the Board refuses to register a transfer of a certificated share it shall, as soon as practicable and in any event within two months after the date on which the instrument of transfer was lodged, give to the transferee notice of the refusal together with its reasons for refusal. The Board must provide the transferee with such further information about the reasons for the refusal as the transferee may reasonably request. Unless otherwise agreed by the Board in any particular case, the maximum number of persons who may be entered on the register as joint holders of a share is four.

3.5 Alteration of share capital

The Company may exercise the powers conferred by the applicable statutory provisions to:

(a) increase its share capital by allotting new shares;

(b) reduce its share capital, any capital redemption reserve and any share premium account in any way;

(c) sub-divide or consolidate and divide all or any of its share capital;

(d) redenominate all or any of its shares and reduce its share capital in connection with such redenomination;

(e) issue redeemable shares; and

(f) purchase all or any of its own shares including any redeemable shares.

3.6 Authority to allot shares and grant rights and disapplication of pre-emption rights

The Company may from time to time pass an ordinary resolution authorising, in accordance with section 551 of the Companies Act 2006 (the "**Companies Act**"), the Board to exercise all the powers of the Company to allot shares in the Company or to grant rights to subscribe for or to convert any security into shares in the Company up to the maximum nominal amount specified in the resolution. The authority shall expire on the day specified in the resolution (not being more than five years from the date on which the resolution is passed).

Subject (other than in relation to the sale of treasury shares) to the Board being generally authorised to allot shares and grant rights to subscribe for or to convert any security into shares in the Company in accordance with section 551 of the Companies Act, the Company may from time to time resolve, by special resolution, that the Board be given power to allot equity securities for cash as if section 561 of the Companies Act did not apply to the allotment but that power shall be limited: (A) to the allotment of equity securities in connection with a rights issue; and (B) to the allotment (other than in connection with a rights issue) of equity securities having a nominal amount not exceeding in aggregate the sum specified in the special resolution.

3.7 Variation of rights

Whenever the share capital of the Company is divided into different classes of shares, all or any of the rights for the time being attached to any class of shares in issue may from time to time (whether or not the Company is being wound-up) be varied in such manner as those rights may provide or (if no such provision is made) either with the consent in writing of the holders of three-fourths in nominal value of the issued shares of that class or with the authority of a special resolution passed at a separate general meeting of the holders of those shares. At any separate general meeting, the quorum is two members present in person or proxy holding at least one-third in nominal amount of the issued shares of the class in question (but at any adjourned meeting, the quorum is one member present in person or by proxy holding shares of the class).

3.8 Disclosure of interests in shares

If the holder of, or any person appearing to be interested in, any share has been given a notice requiring any of the information mentioned in section 793 of the Act (section 793 notice) and, in respect of that share (a default share), has been in default for a period of 14 days after the section 793 notice has been given in supplying to the Company the information required by the section 793 notice, the following restrictions shall apply: (A) if the default shares in which any one person is interested or appears to the Company to be interested represent less than 0.25% of the issued shares of the class, the holders of the default shares shall not be entitled, in respect of those shares, to attend or to vote, either personally or by proxy, at any general meeting of the Company; or (B) if the default shares in which any one person is interested or appears to the Company to be interested represent at least 0.25% of the issued shares of the class, the holders of the default shares shall not be entitled, in respect of those shares:

(a) to attend or to vote, either personally or by proxy, at any general meeting of the Company; or

(b) to receive any dividend or other distribution; or

(c) to transfer or agree to transfer any of those shares or any rights in them.

3.9 Uncertificated shares—general powers

In relation to any uncertificated share, the Company may utilise the relevant system in which it is held to the fullest extent available from time to time in the exercise of any of its powers or functions under any applicable statutory provision or the articles of association or otherwise in effecting any action. Any provision in the articles of association in relation to uncertificated shares which is inconsistent with any applicable statutory provision shall not apply. The Company may, by notice to the holder of an uncertificated share, require the holder to change the form of that share to certificated form within such period as may be specified in the notice. For the purpose of effecting any action by the Company, the Board may determine that shares held by a person in uncertificated form and in certificated form shall be treated as separate holdings but they shall not be treated as separate classes of shares.

3.10 Directors

(a) The directors (other than alternate directors) shall not, unless otherwise determined by an ordinary resolution of the Company, be less than two.

(b) A director need not be a member of the Company.

(c) At each annual general meeting, every director shall retire from office. A retiring director shall be eligible for re-election, and a director who is re-elected will be treated as continuing in office without a break. A retiring director who is not re-elected shall retain office until the close of the meeting at which he retires. If the Company, at any meeting at which a director retires in accordance with the articles of association, does not fill the office vacated by such director, the retiring director, if willing to act, shall be deemed to be re-elected, unless at the meeting a resolution is passed not to fill the vacancy or to elect another person in his place or unless the resolution to re-elect him is put to the meeting and lost.

(d) The directors shall be paid such fees not exceeding in aggregate £2,000,000 per annum (or such larger sum as the Company may, by ordinary resolution, determine) as the directors may decide to be divided among them in such proportion and manner as they may agree, or failing agreement, equally.

(e) The Board may grant special remuneration to any director who performs any special or extra services to or at the request of the Company. Such special remuneration may be paid by way of lump sum, salary, commission, participation in profits or otherwise as the Board may decide in addition to his ordinary remuneration (if any) as a director.

(f) The directors shall also be paid out of the funds of the Company all expenses properly incurred by them in and about the discharge of their duties, including their expenses of travelling to and from the Board meetings, committee meetings and general meetings.

(g) The Board may exercise all the powers of the Company to:

(A) pay, provide, arrange or procure the grant of pensions or other retirement benefits, and death, disability or sickness benefits, health, accident and other insurances or other such benefits, allowances, gratuities or insurances, including in relation to the termination of employment, to or for the benefit of any person who is or has been at any time a director of the Company or in the employment or service of the Company or of any body corporate which is or was associated with the Company or of the predecessors in business of the Company or any such associated body corporate or the relatives or dependants of any such person. For that purpose the Board may procure the establishment and maintenance of, or participation in, or contribution to, any pension fund, scheme or arrangement or the payment of any insurance premiums;

(B) establish, maintain, adopt and enable participation in any profit sharing or incentive scheme including shares, share options or cash or any similar schemes for the benefit of any director or employee of the Company or of any associated body corporate, and to lend money to any such director or employee or to trustees on their behalf to enable any such schemes to be established, maintained or adopted; and

(C) support and subscribe to any institution or association which may be for the benefit of the Company or of any associated body corporate or any directors or employees of the Company or associated body corporate or their relatives or dependants or connected with any town or place where the Company or an associated body corporate carries on business, and to support and subscribe to any charitable or public object whatsoever.

(h) If a situation (a "**Relevant Situation**") arises in which a director has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the Company but which does not arise in relation to a transaction or arrangement with the Company, the director must declare the nature and extent of his interest to the other directors and the directors (other than the director, and any other director with a similar interest, who shall not be counted in the quorum at the meeting and shall not vote on the resolution) may: (i) if the Relevant Situation arises from the appointment or proposed appointment of a person as a director of the Company, resolve to authorise the appointment of the director and the Relevant Situation on such terms as they may determine; and (ii) if the Relevant Situation arises in other circumstances, resolve to authorise the Relevant Situation and the continuing performance by the director of his duties on such terms as they may determine. Any terms of such authorisation may be imposed at the time of the authorisation or may be imposed or varied subsequently and may include (without limitation):

(A) whether the interested directors may vote (or be counted in the quorum at a meeting) in relation to any resolution relating to the Relevant Situation;

(B) the exclusion of the interested directors from all information and discussion by the Company of the Relevant Situation; and

(C) (without prejudice to the general obligations of confidentiality) the application to the interested directors of a strict duty of confidentiality to the Company for any confidential information of the Company in relation to the Relevant Situation.

(i) Any authorisation of a Relevant Situation may provide that, where the interested director obtains (other than through his position as a director of the Company) information that is confidential to a third party, he will not be obliged to disclose it to the Company or to use it in relation to the Company's affairs in circumstances where to do so would amount to a breach of that confidence.

(j) If a director is in any way, directly or indirectly, interested in a proposed or an existing transaction or arrangement with the Company, he must declare the nature and extent of that interest to the other directors.

(k) Subject to any applicable statutory provisions and to having declared his interest to the other directors, a director may:

(A) enter into or be interested in any transaction or arrangement with the Company, either with regard to his tenure of any office or position in the management, administration or conduct of the business of the Company, or as vendor, purchaser or otherwise;

(B) hold and be remunerated in respect of any other office or place of profit with the Company (except that of auditor) in conjunction with his office of director;

(C) act by himself or his firm in a professional capacity for the Company (except as auditor) and be entitled to remuneration for professional services as if he were not a director;

(D) be or become a member or director of, or hold any other office or place of profit under, or otherwise be interested in, any holding company or subsidiary undertaking of that holding company or any other company in which the Company may be interested; and

(E) be or become a director of any other company in which the Company does not have an interest if that cannot reasonably be regarded as likely to give rise to a conflict of interest at the time of his appointment as a director of that other company.

(l) A director shall not vote (or be counted in the quorum at a meeting) in respect of any resolution concerning his own appointment (including fixing and varying its terms), or the termination of his own appointment, as the holder of any office or place of profit with the Company or any other company in which the Company is interested but, where proposals are under consideration concerning the appointment (including fixing or varying its terms), or the termination of the appointment, of two or more directors to offices or places of profit with the Company or any company in which the Company is interested, those proposals may be divided and considered in relation to each director separately; and in such case each of the directors concerned (if not otherwise debarred from voting under the articles of association) shall be entitled to vote (and be counted in the quorum) in respect of each resolution except that concerning his own appointment or the termination of his own appointment.

(m) A director shall not vote (or be counted in the quorum at a meeting) in respect of any transaction or arrangement with the Company in which he has an interest which may reasonably be regarded as likely to give rise to a conflict of interest. Notwithstanding the above, a director may vote (and be counted in the quorum) on: (A) any transaction or arrangement in which he is interested by virtue of an interest in shares, debentures or other securities of the Company or otherwise in or through the Company; (B) the giving of any guarantee, security or indemnity in respect of money lent or obligations incurred by him or by any other person at the request of, or for the benefit of, the Company or any of its subsidiary undertakings; or a debt or obligation of the Company or any of its subsidiary undertakings for which he himself has assumed responsibility in whole or in part (either alone or jointly with others) under a guarantee or indemnity or by the giving of security; (C) indemnification (including loans made in connection with it) by the Company in relation to the performance of his duties on behalf of the Company or of any of its subsidiary undertakings; (D) any issue or offer of shares, debentures or other securities of the Company or any of its subsidiary undertakings in respect of which he is or may be entitled to participate in his capacity as holder of any such securities or as an underwriter or sub-underwriter; (E) any transaction or arrangement concerning any other company in which he does not hold, directly or indirectly as shareholder, or through his direct or indirect holdings of financial instruments (within the meaning of Chapter 5 of the Disclosure and Transparency Rules) voting rights representing one per cent. or more of any class of shares in the capital of such company; (F) any arrangement for the benefit of employees of the Company or any of its subsidiary undertakings which does not accord to him any privilege or benefit not generally accorded to the employees to whom the arrangement relates; and (G) the purchase or maintenance of insurance for the benefit of directors or for the benefit of persons including directors.

3.11 General meetings

An annual general meeting shall be held in accordance with the applicable statutory provisions at such place as may be determined by the Board. Other general meetings shall be held whenever the Board thinks fit or on the requisition of shareholders in accordance with the Act.

Subject to the applicable statutory provisions, an annual general meeting shall be called by at least 21 clear days' notice and all other general meetings shall be called by not less than 14 clear days' notice or by not less than such minimum notice period as is permitted by the applicable statutory provisions.

The requisite quorum for general meetings of the Company shall be two qualifying persons, representing different members and entitled to vote on the business to be transacted at the meeting. A

qualifying person is an individual who is a member of the Company; a corporate representative; or a proxy.

3.12 Borrowing powers

There is no requirement on the directors to restrict the borrowing of the Company or any of its subsidiary undertakings.

3.13 Change of name

The Board may change the name of the Company.

3.14 Dividends

(a) Declaration of dividends—the Company may, by ordinary resolution, declare a dividend to be paid to the members, according to their respective rights and interests in the profits, and may fix the time for payment of such dividend, but no dividend shall exceed the amount recommended by the Board.

(b) Fixed and interim dividends—the Board may pay such interim dividends as appear to the Board to be justified by the financial position of the Company and may also pay any dividend payable at a fixed rate at intervals settled by the Board whenever the financial position of the Company, in the opinion of the Board, justifies its payment. If the Board acts in good faith, none of the directors shall incur any liability to the holders of shares conferring preferred rights for any loss such holders may suffer in consequence of the payment of an interim dividend on any shares having non-preferred or deferred rights.

(c) Calculation and currency of dividends—except insofar as the rights attaching to, or the terms of issue of, any share otherwise provide: (A) all dividends shall be declared and paid according to the amounts paid up on the shares in respect of which the dividend is paid, but no amount paid up on a share in advance of calls shall be treated as paid up on the share; (B) all dividends shall be apportioned and paid pro rata according to the amounts paid up on the shares during any portion or portions of the period in respect of which the dividend is paid; and (C) dividends may be declared or paid in any currency and the Board may agree with any member that dividends which may at any time or from time to time be declared or become due on his shares in one currency shall be paid or satisfied in another, and may agree the basis of conversion to be applied and how and when the amount to be paid in the other currency shall be calculated and paid and for the Company or any other person to bear any costs involved.

(d) Dividends not to bear interest—no dividend or other moneys payable by the Company on or in respect of any share shall bear interest as against the Company unless otherwise provided by the rights attached to the share.

(e) Calls or debts may be deducted from dividends—the Board may deduct from any dividend or other moneys payable to any person (either alone or jointly with another) on or in respect of a share all such sums as may be due from him (either alone or jointly with another) to the Company on account of calls or otherwise in relation to shares of the Company.

(f) Dividends in specie—with the authority of an ordinary resolution of the Company and on the recommendation of the Board, payment of any dividend may be satisfied wholly or in part by the distribution of specific assets and in particular of paid up shares or debentures of any other company.

(g) Scrip dividends—the Board may, with the authority of an ordinary resolution of the Company, offer any holders of shares the right to elect to receive further shares by way of scrip dividend instead of cash in respect of all (or some part) of any dividend specified by the ordinary resolution.

(h) Unclaimed dividends—any dividend unclaimed for a period of 12 years after having been declared shall be forfeited and cease to remain owing by the Company.

3.15 Forfeiture of shares

If the whole or any part of any call or instalment remains unpaid on any share after the due date for payment, the Board may give a notice to the holder requiring him to pay so much of the call or instalment as remains unpaid, together with any accrued interest.

If the requirements of a notice are not complied with, any share in respect of which it was given may (before the payment required by the notice is made) be forfeited by a resolution of the Board. The forfeiture shall include all dividends declared and other moneys payable in respect of the forfeited share and not actually paid before the forfeiture.

Every share which is forfeited or surrendered shall become the property of the Company and (subject to the applicable statutory provisions) may be sold, re-allotted or otherwise disposed of, upon such terms and in such manner as the Board shall decide either to the person who was before the forfeiture the holder of the share or to any other person and whether with or without all or any part of the amount previously paid up on the share being credited as so paid up.

3.16 Communications by the Company

Subject to the applicable statutory provisions, a document or information may be sent or supplied by the Company to any member in electronic form to such address as may from time to time be authorised by the member concerned or by making it available on a website and notifying the member concerned (in accordance with the applicable statutory provisions) of the presence of a document or information on the website. A member shall be deemed to have agreed that the Company may send or supply a document or information by means of a website if the applicable statutory provisions have been satisfied.

3.17 Directors' indemnity, insurance and defence

As far as the applicable statutory provisions allow, the Company may:

(a) indemnify any director of the Company (or of an associated body corporate) against any liability;

(b) indemnify a director of a company that is a trustee of an occupational pension scheme for employees (or former employees) of the Company (or of an associated body corporate) against liability incurred in connection with the company's activities as trustee of the scheme;

(c) purchase and maintain insurance against any liability for any director referred to in (a) or (b) above; and

(d) provide any director referred to in (a) or (b) above with funds (whether by loan or otherwise) to meet expenditure incurred or to be incurred by him in defending any criminal, regulatory or civil proceedings or in connection with an application for relief (or to enable any such director to avoid incurring such expenditure).

4. Directors and Senior Management

4.1 The biographies of the Directors and of Senior Management are set out in Part VIII: "*Directors, Senior Management and Corporate Governance*".

4.2 The business address of each of the Directors and each member of Senior Management is Churchill Court, Westmoreland Road, Bromley BR1 1DP, United Kingdom.

4.3 In addition to their directorships of the Company and other members of the Group, the Directors and members of Senior Management hold, or have held, the following directorships and are or were members of the following partnerships, within the past five years:

Name	Position	Company/ Partnership	Position still held (Y/N)
Michael Nicholas Biggs . . .	Director	RSL Servco Limited	Y
	Director	Pearl Life Holdings Limited	N
	Director	Pearl RLG Limited	N
	Director	Ignis Asset Management Limited	N
	Director	Ignis Fund Managers Limited	N

Name	Position	Company/ Partnership	Position still held (Y/N)
	Director	Ignis Investment Services Limited	N
	Director	Pearl Group Holdings (No. 1) Limited	N
	Director	Pearl Group Management Services Limited	N
Paul Robert Geddes	Director	Natwest Personal Finance Management Limited	N
	Director	Aviva (Peak No.1) UK Limited	N
	Director	Aviva (Peak No.2) UK Limited	N
	Director	Aviva Life Investments UK Limited	N
	Director	RBS Collective Investment Funds Limited	N
	Director	RBS Life Holdings Limited	N
	Director	RBSG Collective Investments Holdings Limited	N
	Director	RBSG Collective Investments Limited	N
	Director	Trinity Trustee Company Limited	N
	Director	Undershaft (Peak No.3) UK Limited	N
	Director	Dewar Arts Awards	N
Anthony Jonathan Reizenstein	Director	The Co-operative Bank plc	N
	Director	CFS Management Services Limited	N
	Director	The Co-operative Asset Management Limited	N
	Director	CIS General Insurance Limited	N
	Director	The Co-operative Insurance Society Limited	N
	Director	The Co-operative Insurance Society Limited	N
	Director	Britannia Treasury Services Limited	N
	Director	Illius Properties Limited	N
	Director	Platform Home Loans Limited	N
	Director	Mortgage Agency Services Number Five Limited	N
	Director	Mortgage Agency Services Number Four Limited	N
	Director	Mortgage Agency Services Number One Limited	N
	Director	Mortgage Agency Services Number Seven Limited	N
	Director	Mortgage Agency Services Number Six Limited	N
	Director	Mortgage Agency Services Number Two Limited	N
	Director	Platform Funding Limited	N

Name	Position	Company/ Partnership	Position still held (Y/N)
Glyn Parry Jones	Director	Aspen Insurance UK Limited	Y
	Director	Towry Holdings Limited	N
	Director	Hermes Fund Managers Limited	N
	Director	BT Pension Scheme Management Limited	N
Andrew William Palmer . .	Director	Segro plc	Y
	Director	The Royal School of Needlework	Y
	Director	RSN Enterprises Limited	Y
	Director	Legal & General Investment Management Dormant (Holdings) Limited	N
	Director	Legal & General Finance plc	N
	Director	Legal & General Retail (Holdings) Limited	N
	Director	Legal & General Insurance Holdings Limited	N
	Director	Legal & General Co Sec Limited	N
	Director	Legal & General Pensions Limited	N
	Director	Legal & General Insurance Holdings No.2 Limited	N
	Director	Legal and General Assurance Society Limited	N
	Director	Legal & General Group plc	N
	Director	The Royal London Mutual Insurance Society Limited	Y
Jane Carolyn Hanson	Director	JCH Associates (UK) Limited	Y
	Director	Reclaim Fund Ltd	Y
Priscilla Audrey Vacassin . .	Director	Prudential Staff Pensions Limited	N
	Director	Prudential Services Limited	N
Clare Eleanor Thompson .	Director	Autistica	Y
	Director	Disasters Emergency Committee	Y
	Member of partnership board	Miller Insurance Services LLP	Y
	Member	PricewaterhouseCoopers LLP	N
	Partner	PricewaterhouseCoopers (and predecessor firms)	N
Bruce Winfield Van Saun .	Director	BNY Convergex LLC	Y
	Director	Ship Midco Limited	Y
	Director	National Westminster Bank plc	Y
	Director	RBS NV Supervisory Board	Y
	Director	The Royal Bank of Scotland Group plc	Y
	Director	The Royal Bank of Scotland plc	Y
	Director	Society of Lloyds Franchise Board	Y

Name	Position	Company/ Partnership	Position still held (Y/N)
Thomas Woolgrove	Director	Bank of Scotland Foundation	N
	Director	Bank of Scotland Insurance Services Limited	N
	Director	Capital Bank Insurance Services Limited	N
	Director	EES Capital Trustees Limited	N
	Director	EES Corporate Trustees Limited	N
	Director	EES Services (UK) Limited	N
	Director	EES Trustees Limited	N
	Director	Halifax Assurance Ireland Limited	N
	Director	Halifax General Insurance Services Limited	N
	Director	Halifax Insurance Ireland Limited	N
	Director	Halifax Jersey Holdings Limited	N
	Director	HBOS GI plc	N
	Director	HBOS General Insurance Services Limited	N
	Director	Lloyds TSB Independent Financial Advisers Limited	N
	Director	Lloyds TSB Private Banking Limited	N
	Director	Mentor Professional Services Limited	N
	Director	St. Andrew's Group plc	N
	Director	St. Andrew's Insurance plc	N
	Director	St. Andrew's Membership Services Limited	N
	Director	St. Andrew's Shell Company Limited	N
	Director	Stams Limited	N
Steven Maddock	Director	Insurance Fraud Bureau	Y
	Director	Motor Insurers' Bureau	Y
Darrell Paul Evans	Director	National Westminster Home Loans Limited	N
	Director	The One Account Limited	N
	Director	Lombard Home Loans Limited	N
	Director	Lombard Bank	N
	Director	Deritt Insurances Services Limited	N
James Chalmers Brown . . .	Director	Chaletfood Limited	N
Jose Rafael Vazquez	Director	ZPC Capital Limited	N
	Director	Zurich Holdings (UK) Limited	N
	Director	Zurich Insurance Company (U.K.) Limited	N
	Director	HSBC Insurance (Bermuda) Limited	N

Name	Position	Company/ Partnership	Position still held (Y/N)
	Director	HSBC Insurance Holdings Limited	N
Mark Terry Martin	Director	Deutsche Telekom (UK) Limited	N
	Director	Everything Everywhere Limited	N
	Director	Everything Everywhere Pension Trustee Limited	N
Sheree Kim Howard	Director	Lothbury Insurance Company Limited	N
Robert Clement Bailhache	Director	Global Capital Communications Limited	Y
	Director	Bailhache Communications Limited	Y
	Director	Capital Market Consulting Limited	Y
	Director	Basis Point Limited	Y

4.4 At the date of this Prospectus, none of the Directors and members of the Senior Management has at any time within at least the past five years:

(a) save as disclosed in this paragraph 4, been director or partner of any companies or partnerships; or

(b) had any convictions in relation to fraudulent offences (whether spent or unspent); or

(c) been adjudged bankrupt or entered into an individual voluntary arrangement; or

(d) been a director of any company at the time of, or within 12 months preceding, any receivership, compulsory liquidation, creditors voluntary liquidation, administration, company voluntary arrangement or any composition or arrangement with that company's creditors generally or with any class of its creditors; or

(e) been a partner in a partnership at the time of, or within 12 months preceding, any compulsory liquidation, administration or partnership voluntary arrangement of such partnership; or

(f) had his assets form the subject of any receivership or has been a partner of a partnership at the time of, or within 12 months preceding, any assets thereof being the subject of a receivership; or

(g) been subject to any official public incrimination and/or sanctions by any statutory or regulatory authority (including any designated professional body); or

(h) ever been disqualified by a court from acting as a director of a company or from acting in the management or conduct of the affairs of any company.

5. Directors' and Senior Managers' Interests in the Company

5.1 As at the date of this Prospectus, and as is expected to be the position immediately following Admission, except as disclosed in paragraph 5.2 below, and in note 2 of paragraph 6.5, neither the Directors nor the Senior Managers, and none of their respective immediate families, have any interests in the share capital of the Company which:

(a) are required to be notified to the Company pursuant to Chapter 3 of the Disclosure and Transparency Rules;

(b) are interests of a connected person (within the meaning of Schedule 11B of FSMA) which would be required to be disclosed under (a) above and the existence of which is known to or could with reasonable diligence be ascertained by that Director or Senior Manager, as at the date of the Prospectus; or

(c) would have been required to be disclosed by paragraphs (a) or (b) above if the relevant Senior Manager had been a PDMR of the Company.

5.2 Certain Directors and Senior Managers have agreed to acquire a fixed sterling amount of Ordinary Shares from the Selling Shareholder at the Offer Price, conditional only on Admission, and therefore have the following interests in the share capital of the Company (all of which are beneficial or are interests of a person connected with a Director or Senior Manager):

Name	Number of Ordinary Shares before Admission	Percentage of Ordinary Shares before Admission	Number of Ordinary Shares after Admission[1]	Percentage of Ordinary Shares after Admission[1]
Paul Geddes	—	—	56,179[2]	0.00%
John Reizenstein	—	—	56,179	0.00%
Andrew Palmer	—	—	11,235[2]	0.00%
Jane Hanson	—	—	28,089	0.00%
Clare Thompson	—	—	28,089	0.00%
Priscilla Vacassin	—	—	28,089	0.00%
Tom Woolgrove	—	—	16,853	0.00%
Darrell Evans	—	—	14,044[2]	0.00%
Steve Maddock	—	—	16,853	0.00%
Jonathan Davidson	—	—	56,179	0.00%
Mark Evans	—	—	28,089	0.00%
Rob Bailhache	—	—	11,235[2]	0.00%
Humphrey Tomlinson	—	—	16,853	0.00%
Sheree Howard	—	—	14,044[2]	0.00%
Jose Vazquez	—	—	16,853	0.00%

Notes:

(1) Assumes Offer Price set at mid-level of Price Range.

(2) Includes holdings of connected persons (as defined in section 252-255 of the Companies Act).

5.3 The interests of the Directors and Senior Managers together represent 0% of the issued share capital of the Company as at the date of this Prospectus and will represent 0% of the issued share capital of the Company on Admission, assuming the Offer Price is set at the mid-point of the Price Range.

5.4 Save as set out in this Part XVI, it is not expected that any Director will have any interest in the share or loan capital of the Company on Admission and there is no person to whom any capital of any member of the Group is under award or option or agreed unconditionally to be put under award or option.

5.5 As at the date of this Prospectus, in so far as it is known to the Company, the name of each person, other than a Director, who holds voting rights (within the meaning of Chapter 5 of the Disclosure and Transparency Rules) representing 3% or more of the total voting rights in respect of the Company's existing share capital, and the amount of such person's holding, is (and following Admission is expected to be) as follows:

Name	No. and class of existing shares	Percentage of existing share capital	No. of Ordinary Shares after Admission[1]	Percentage of issued share capital after Admission[1]
The Royal Bank of Scotland Group plc	1,500 million	100%	1,062,500,000	70.8%

Notes:

(1) Assumes the number of Offer Shares sold is the mid-point between 25.0% and 33.3% of the total number of issued Ordinary Shares and no exercise of the Over-allotment Option

5.6 Save as disclosed in this paragraph 5, the Directors are not aware of any holdings of voting rights (within the meaning of Chapter 5 of the Disclosure and Transparency Rules) which will represent 3% or more of the total voting rights in respect of the issued share capital of the Company following Admission.

5.7 The Selling Shareholder is the only person known to the Company who directly or indirectly, could exercise or does exercise control over the Company and holds the proportions of voting capital set out in paragraph 5.5 above.

5.8 There are no differences between the voting rights enjoyed by the shareholder described in paragraph 5.7 above and those enjoyed by any other holder of Ordinary Shares in the Company.

5.9 For a description of the measures in place to ensure that the control exercised over the Company by the Selling Shareholder is not abused, please see paragraph 12.3 of Part XVI: "*Additional Information—Relationship Agreement*".

5.10 Bruce Van Saun is a director of the Selling Shareholder and certain other entities within the Selling Shareholder's Group. Mark Catton is chief executive, UK Corporate and Institutional Banking at The Royal Bank of Scotland Group plc and is a member of the RBS Group's Management Committee. Save as disclosed in this paragraph 5.10, none of the Directors has any potential conflicts of interest between their duties to the Company and their private interests and/or their duties to third parties.

5.11 Except as set out in paragraph 5.12 below, the Company and the Directors are not aware of any arrangements, the operation of which may at a subsequent date result in a change in control of the Company.

5.12 As part of the State Aid restructuring plan, the RBS Group has a legal obligation to divest its controlling interest in the Group by the end of 2013 and completely divest by the end of 2014.

6. Remuneration and Benefits

Introduction

The DLG Remuneration Committee has determined a policy of setting pay by reference to median market pay in the context of FTSE 31 to 100 listed companies and insurance peers and the remuneration levels and structures for Executive Directors have been determined in line with that policy.

The remuneration framework in respect of the Executive Directors is a combination of base salary, benefits, annual incentive award and employee share plans. The employee share plans the Company will be able to operate following Admission are described in paragraphs 7.3 to 7.7.

As regards the annual incentive award, this is intended to cascade across the Group. The maximum total annual incentive award opportunity (including cash and shares) for Paul Geddes will be 175% of salary and the maximum opportunity for John Reizenstein will be 150% of salary. The performance measures for the financial year ending 31 December 2013 will be a suitable combination of financial and non-financial measures except that employees within the internal audit, risk and compliance functions will not have financial measures. For all senior employees, it is currently intended that 40% of the total annual incentive award opportunity will be deferred into awards over Ordinary Shares under the DLG Deferred Annual Incentive Plan which is summarised in paragraph 7.5, with such awards vesting after a three year period. The DLG Remuneration Committee intends to make the first awards under the DLG Deferred Annual Incentive Plan in respect of any annual incentive awards achieved by reference to the performance measures originally set for individuals in respect of the financial year ending 31 December 2012.

Whilst the arrangements described above are the Company's current policy for deferral of annual incentive outcomes, it is acknowledged that the Company may be required to adjust these deferral percentages to comply with future regulatory requirements relevant to the insurance industry, including the remuneration-related aspects of Solvency II when these are published and introduced. Therefore, the Committee has discretion to consider the deferral percentages as stated and may, if appropriate, change them prior to approving any final bonus awards, taking into account developments in best practice in doing so.

Also, while the Company remains a part of the RBS Group, the requirements of the FSA Remuneration Code with respect to the deferral of variable pay will be applied to any individuals whose pay arrangements are subject to such regulation. Given that insurance companies are not generally subject to regulation under the FSA Remuneration Code, the FSA Remuneration Code will impact only Paul Geddes in relation to 2012 annual incentive outcomes (by virtue of Paul Geddes being an RBS Group executive committee member for part of that year). Accordingly, and to ensure compliance with the FSA Remuneration Code requirements, any annual incentive outcomes for Paul Geddes in respect of 2012 will have a deferral profile that matches that of RBS Group's annual incentive arrangements (except that any share element will be satisfied in Ordinary Shares).

6.1 The Executive Directors have service agreements with the Company as follows:

Chief Executive Officer

(a) Paul Geddes receives a salary of £760,000 per annum under his service agreement effective from the first of the month of the date of Admission. He is eligible to participate in the employee share plans established by the Company from time to time, at the discretion of the DLG Remuneration Committee. The employee share plans to be operated by the Company following Admission are summarised in paragraph 7.3 to 7.7 and the initial award to be made to Paul Geddes following Admission under the DLG Long-Term Incentive Plan is summarised in paragraph 7.2.

(b) He is also eligible to participate in the Company's annual incentive plan, at the discretion of the DLG Remuneration Committee. The DLG Remuneration Committee intends that part of any total annual incentive award will be deferred into Ordinary Shares under the DLG Deferred Annual Incentive Plan summarised in paragraph 7.4 and, in respect of any bonus for the year to 31 December 2012, the deferral profile will match that of RBS Group's annual incentive arrangements.

(c) Under his service agreement, Paul Geddes is also entitled to the following benefits:

(i) Life Assurance cover at a rate of eight times his salary with the option of decreasing the level of cover to a minimum of one times his salary and receiving the remainder in cash; income protection to the value of 50% of his salary for five years in the event of incapacity; private medical cover for himself and family but with an option to increase the level of cover, subject to a salary deduction; an annual health check; and an annual car allowance of £12,000 that can be taken as cash in monthly instalments or used to buy or lease a car. Paul Geddes is automatically enrolled into the Company pension scheme with an employer contribution of 25% of his salary, although he has the option to opt out of the pension arrangements or to decrease the level of contribution and receive payment of the balance in cash or increase the amount of contributions which are deducted from salary. He is eligible for cover under any director and officer insurance that the Company may maintain from time to time.

(ii) The service agreement can be terminated by either party on service of 12 months' written notice. The Company has the ability to make a payment in lieu of notice equal to the base salary element of Paul Geddes' remuneration for any unexpired portion of the notice period. This can be paid as a lump sum or, at the discretion of the Company (reflecting the decision or recommendation of the Remuneration Committee), in monthly instalments in which case, Paul Geddes will be obliged to seek alternative remuneration, with the monthly instalments being reduced accordingly. The Company also reserves the right to place Paul Geddes on garden leave during his notice period. Under the service agreement the Company is entitled to dismiss Paul Geddes without notice in certain specified circumstances such as gross incompetence or following any serious or persistent breach of duties. For as long as RBS owns more than 50% of the Ordinary Shares, Paul Geddes' service agreement will continue to have the RBS Group policy provision regarding termination without notice or payment in lieu when personal underperformance is not remedied following a warning from the Board and after reasonable opportunity to remedy it has been given. The service agreement provides that Paul Geddes is not eligible to receive any enhanced redundancy terms which may be offered by the Company from time to time. His rights to a statutory redundancy payment are not affected.

(iii) Paul Geddes' service agreement contains confidentiality provisions which are unlimited in time and restrictive covenants lasting for a period of six months (in the case of non-compete) and 12 months in the case of, for instance, non-solicitation after the termination of his employment, less any period in which he is placed on garden leave. The confidentiality provisions apply to the confidential information of any DLG Group Company and any RBS Group Company for as long as the Company remains a subsidiary within the RBS Group and exclude confidential information disclosed in accordance with public information disclosure legislation or a court order.

Chief Financial Officer

(a) John Reizenstein receives a salary of £460,000 per annum under his service agreement effective from the first of the month of the date of Admission. He is eligible to participate in the employee share plans established by the Company from time to time, at the discretion of the DLG

Remuneration Committee. The employee share plans to be operated by the Company following Admission are summarised in paragraphs 7.3 to 7.7 and the initial award to be made to John Reizenstein following Admission under the DLG Long-Term Incentive Plan is summarised in paragraph 7.2.

(b) He is also eligible to participate in the Company's annual incentive plan, at the discretion of the DLG Remuneration Committee. The DLG Remuneration Committee intends that part of any total annual incentive award will be deferred into Ordinary Shares under the DLG Deferred Annual Incentive Plan summarised in paragraph 7.4.

(c) Under his service agreement, John Reizenstein is also entitled to the following benefits:

(i) Life Assurance cover at a rate of eight times his salary with the option of decreasing the level of cover to a minimum of one times his salary and receiving the remainder in cash; income protection to the value of 50% of his salary for five years in the event of incapacity; private medical cover for himself and family but with an option to increase the level of cover, subject to a salary deduction; an annual health check; and an annual car allowance of £12,000 that can be taken as cash in monthly instalments or used to buy or lease a car. John Reizenstein is automatically enrolled into the Company pension scheme with an employer contribution of 25% of his salary, although he has the option to opt out of the pension arrangements or to decrease the level of contribution and receive payment of the balance in cash or increase the amount of contributions which are deducted from his salary. He is eligible for cover under any director and officer insurance that the Company may maintain from time to time.

(ii) The service agreement can be terminated by either party on service of 12 months' written notice. The Company has the ability to make a payment in lieu of notice equal to the base salary element of John Reizenstein's remuneration for any unexpired portion of the notice period. This can be paid as a lump sum or, at the discretion of the Company (reflecting the decision or recommendation of the Remuneration Committee), in monthly instalments in which case, John Reizenstein will be obliged to seek alternative remuneration, with the monthly instalments being reduced accordingly. The Company also reserves the right to place John Reizenstein on garden leave during his notice period. Under the service agreement, the Company is entitled to dismiss John Reizenstein without notice in certain specified circumstances, such as gross incompetence or following any serious or persistent breach of duties. For as long as RBS owns more than 50% of the Ordinary Shares, John Reizenstein's service agreement will contain from Admission the RBS Group policy regarding termination without notice or payment in lieu when personal underperformance is not remedied following a warning from the Board and after reasonable opportunity to remedy it has been given. The service agreement provides that John Reizenstein is not eligible to receive any enhanced redundancy terms which may be offered by the Company from time to time. His rights to a statutory redundancy payment are not affected.

(iii) John Reizenstein's service agreement contains confidentiality provisions which are unlimited in time and restrictive covenants lasting for a period of six months (in the case of non-compete) and 12 months in the case of, for instance, non-solicitation after the termination of his employment, less any period in which he is placed on garden leave. The confidentiality provisions apply to the confidential information of any DLG Group Company and any RBS Group Company for as long as the Company remains a subsidiary within the RBS Group and exclude confidential information disclosed in accordance with public information disclosure legislation or a court order.

6.2 Each of the Non-Executive Directors has agreed terms of appointment with the Company as follows:

(a) The appointment of each of the Non-Executive Directors is from the appointment date listed in paragraph 6.3 below until the conclusion of the Company's Annual General Meeting occurring approximately three years from that date, subject to re-election by shareholders.

(b) The appointment of each Non-Executive Director may be terminated at any time by either the Company or Non-Executive Director giving to the other party three months' written notice.

(c) The basic annual Non-Executive Director fee for each of Andrew Palmer, Jane Hanson, Priscilla Vacassin, Mark Catton, Clare Thompson and Bruce Van Saun is £70,000. Glyn Jones, as the Senior Independent Non-Executive Director, is entitled to a basic annual fee of £100,000. Bruce Van Saun's and Mark Catton's fee will be paid to the Selling Shareholder. Any Non-Executive

Director who is a member of the Audit Committee, the Board Risk Committee or the Remuneration Committee will be entitled to an additional fee of £10,000 (£5,000 for the Nomination Committee). The additional fee for chairing the Audit Committee, the Board Risk Committee or the Remuneration Committee is £30,000.

(d) Each Non-Executive Director is also entitled to reimbursement for reasonable and properly documented expenses incurred in performing their duties.

(e) As Chairman, Michael Biggs is entitled to an annual fee of £400,000.

(f) The Non-Executive Directors are not entitled to receive any compensation for loss of office and are not entitled to participate in the Company's bonus, employee share plan or pension arrangements.

(g) Each Non-Executive Director is subject to confidentiality restrictions both during the appointment and after it has ended.

(h) Each Non-Executive Director will be entitled to cover under the director and officer insurance maintained from time to time.

6.3 Details of the Directors' appointments and term of office are as follows:

Name	Position	Appointment date	Date service agreement/ letter of appointment takes effect	Expiry of current term of office
Michael Biggs	Non-executive Chairman	27 April 2012	1 August 2012	Conclusion of the first annual general meeting falling after 27 April 2015 subject to re-election
Paul Geddes	Chief Executive Officer	12 August 2009	1 September 2012	By either party giving 12 months written notice
John Reizenstein . .	Chief Financial Officer	18 February 2011	1 September 2012	By either party giving 12 months written notice
Glyn Jones	Senior Independent Non-executive Director	24 September 2012	24 September 2012	Conclusion of the first annual general meeting falling after 24 September 2015, subject to re-election
Andrew Palmer . . .	Independent Non-executive Director	23 March 2011	1 August 2012	Conclusion of the first annual general meeting falling after 23 March 2014, subject to re-election
Jane Hanson	Independent Non-executive Director	20 December 2011	1 August 2012	Conclusion of the first annual general meeting falling after 20 December 2014, subject to re-election
Clare Thompson . .	Independent Non-executive Director	3 September 2012	3 September 2012	Conclusion of the first annual general meeting falling after 3 September 2015, subject to re-election
Priscilla Vacassin . .	Independent Non-executive Director	13 September 2012	13 September 2012	Conclusion of the first annual general meeting falling after 13 September 2015, subject to re-election
Bruce Van Saun . . .	Non-executive Director	27 April 2012	27 April 2012	Either the date on which the RBS Group divests its controlling interest in the Group or when RBS owns less than 20% of the Group, subject to re-election (in accordance with the terms of the Relationship Agreement)

Name	Position	Appointment date	Date service agreement/ letter of appointment takes effect	Expiry of current term of office
Mark Catton	Non-executive Director	24 September 2012	24 September 2012	Either the date on which the RBS Group divests its controlling interest in the Group or when RBS owns less than 20% of the Group, subject to re-election (in accordance with the terms of the Relationship Agreement)

6.4 The remuneration paid (including salary and other benefits) to the Directors by the Company for the financial year ended 31 December 2011 was as follows:

Name	Position	Annual salary/fees, bonus and other benefits 2011 (£)[1]
Michael Biggs . .	Non-executive Chairman	n/a
Paul Geddes . . .	Chief Executive Officer	£1,720,757
John Reizenstein	Chief Financial Officer	£949,303
Glyn Jones	Senior Independent Non-executive Director	n/a
Andrew Palmer .	Independent Non-executive Director	£45,036
Jane Hanson . . .	Independent Non-executive Director	£1,644
Clare Thompson	Independent Non-executive Director	n/a
Priscilla Vacassin	Independent Non-executive Director	n/a
Bruce Van Saun	Non-executive Director	n/a
Mark Catton . . .	Non-executive Director	n/a

Note:

(1) This figure includes the cash value of the annual bonus for the financial year ended 31 December 2011 a percentage of which was deferred in the form of an award over ordinary shares in the Selling Shareholder under the RBS Group Deferral Plan and which is shown in the table at paragraph 6.6 below, and the cash value, as at the date of grant, of the 2011 Buyout award granted to John Reizenstein which vests over three years.

6.5 As at 31 December 2011, each of the Executive Directors continued to hold the following awards previously granted to them under the RBS Group Employee Share Plans as employees of the RBS Group, and/or acquired RBS Shares during the financial year ended 31 December 2011 on the vesting of awards previously granted to them under the RBS Group Employee Share Plans, as set out below:

Awards that vested during financial year ended 31 December 2011

Name	Share Plan	Date of grant	Market price at date of award (£)[1]	Number of RBS Shares[1]	Market price of RBS Shares on vesting (£)[1]	Vesting date
Paul Geddes . . .	RBS Group Deferral Plan	7 March 2011	4.45	35,961	4.45	8 March 2011
	RBS Group Deferral Plan	5 March 2010	3.79	39,603	3.90	20 June 2011
	RBS Group Restricted Share Plan	6 March 2008	29.72	3,364	4.39	7 March 2011
John Reizenstein	RBS Group Deferral Plan	7 March 2011	4.45	10,788	4.45	8 March 2011

Awards outstanding as at 31 December 2011

Name	Share Plan	Date of grant	Market price at date of award(£)[1]	Maximum number of RBS Shares[1]	Vesting date
Paul Geddes . . .	RBS Group Long Term Incentive Plan	14 May 2010	4.90	229,779	14 May 2013 subject to performance conditions being achieved
	RBS Group Long Term Incentive Plan[2]	7 March 2011	4.45	337,139	7 March 2014 subject to performance conditions being achieved[3]
	RBS Group Deferral Plan	5 March 2010	3.79	39,602	18 June 2012
	RBS Group Deferral Plan	7 March 2011	4.45	53,941	7 March 2012–7 March 2014 (vesting in three tranches)
	RBS Group Medium-term Performance Plan	22 May 2009	4.09	125,294	22 May 2012 subject to performance conditions being achieved
John Reizenstein	RBS Group Long Term Incentive Plan[2]	7 March 2011	4.45	69,226	7 March 2014 subject to performance conditions being achieved[3]
	RBS Group Deferral Plan	7 March 2011	4.45	7,191	7 March 2012–7 March 2014 (vesting in three tranches)

Notes:

(1) The figures shown above reflect the 1 for 10 consolidation of RBS Shares that was implemented on 6 June 2012.

(2) In order to align the interests of the award holders with Shareholders, the remuneration committee of the Selling Shareholder has determined that participants within the DLG group holding awards granted in 2011 and 2012 under the RBS Group Long Term Incentive Plan will be given the opportunity, conditional on Admission, to have those awards satisfied by the transfer of Ordinary Shares from the Selling Shareholder to the award holder. There will be no new Ordinary Shares issued by the Company to satisfy these awards. The number of Ordinary Shares to which the award will apply will be calculated by taking the product of the number of RBS Shares under award and the average share price of RBS Shares over the five business day period prior to the date on which the Offer Price is determined, and dividing such product by the Offer Price. These awards will remain subject to the terms of the RBS Group Long Term Incentive Plan (including performance criteria, which will be determined by the remuneration committee of the Selling Shareholder at vesting). Ordinary Shares to which the award holder may become entitled may be transferred by the Selling Shareholder to an employee benefit trust following Admission.

(3) Under the rules of the RBS Group Long Term Incentive Plan, award holders would normally be treated as a "good leaver" when RBS ceases to hold a controlling interest in the Company and therefore their award would be subject to time pro rating on vesting. However, the remuneration committee of the Selling Shareholder recognises that it is in the interests of both the Group and the Selling Shareholder to have a well-motivated and appropriately incentivised management team. As a result, the remuneration committee of the Selling Shareholder has determined that those awards that participants have agreed will be satisfied in Ordinary Shares will be capable of vesting in full provided the award holder is still an employee with the Group on the vesting date (and subject to the satisfaction of the relevant performance criteria). Where the award holder has left the Group in good leaver circumstances before the vesting date, the normal time pro rating rules will apply.

6.6 As at the date of this Prospectus, each of the Executive Directors continued to hold the following awards previously granted to them under the RBS Group Employee Share Plans as employees of the RBS Group, and/or acquired RBS Shares during the current financial year ending 31 December 2012 on the vesting of awards previously granted to them under the RBS Group Employee Share Plans, as set out below:

Awards that vested during financial year ending 31 December 2012 up to the latest practicable date prior to publication of this Prospectus

Name	Share Plan	Date of grant	Market price at date of award (£)[1]	Number of RBS Shares[1]	Market price of RBS Shares on vesting (£)[1]	Vesting date
Paul Geddes . . .	RBS Group Deferral Plan	7 March 2011	4.45	17,980	2.80	9 March 2012
	RBS Group Deferral Plan	9 March 2012	2.80	64,308	2.80	9 March 2012
	RBS Group Medium-term Performance Plan	22 May 2009	4.09	75,176	2.16	22 May 2012 (nil cost option exercised on 3 August 2012) The award only vested to the extent that performance conditions were satisfied.
	RBS Group Deferral Plan	5 March 2010	3.79	39,602	2.35	18 June 2012
John Reizenstein	RBS Group Deferral Plan	7 March 2011	4.45	2,397	2.62	7 March 2012
	RBS Group Deferral Plan	7 March 2012	2.80	19,828	2.62	7 March 2012

Awards outstanding as at the latest practicable date prior to publication of this Prospectus

Name	Share Plan	Date of grant	Market price at date of award(£)[1]	Maximum number of RBS Shares[1]	Vesting date
Paul Geddes	RBS Group Long Term Incentive Plan	14 May 2010	4.90	229,779	14 May 2013 subject to performance conditions being achieved
	RBS Group Long Term Incentive Plan[2]	7 March 2011	4.45	337,139	7 March 2014 subject to performance conditions being achieved[3]
	RBS Group Long Term Incentive Plan[2]	9 March 2012	2.80	535,906	9 March 2015 subject to performance conditions being achieved[3]
	RBS Group Deferral Plan	7 March 2011	4.45	35,961	7 March 2013–7 March 2014 (vesting in two tranches)
	RBS Group Deferral Plan	9 March 2012	2.80	96,464	9 March 2013–9 March 2015 (vesting in three tranches)
John Reizenstein . .	RBS Group Long Term Incentive Plan[2]	7 March 2011	4.45	69,226	7 March 2014 subject to performance conditions being achieved[3]
	RBS Group Long Term Incentive Plan[2]	7 March 2012	2.80	120,578	7 March 2015 subject to performance conditions being achieved[3]
	RBS Group Deferral Plan	7 March 2011	4.45	4,794	7 March 2013–7 March 2014 (vesting in two tranches)
	RBS Group Deferral Plan	7 March 2012	2.80	13,219	7 March 2013–7 March 2015 (vesting in three tranches)

Notes:

(1) See Note (1) to paragraph 6.5 above.

(2) See Note (2) to paragraph 6.5 above.

(3) See Note (3) to paragraph 6.5 above.

6.7 The aggregate remuneration paid (including salary and other benefits) to the Senior Managers by the Company and its subsidiaries for the financial year ended 31 December 2011 is £3,966,107. This figure includes the cash value of annual bonuses for the financial year ended 31 December 2011, a percentage of which were deferred in the form of awards over RBS Shares under the RBS Group Deferral Plan and which are shown in the table at paragraph 6.10 below.

6.8 During the financial year ended 31 December 2011, as employees of the RBS Group the Senior Managers were granted, in aggregate, awards over RBS Shares under the RBS Group Employee Share Plans as follows:

Share Plan	Date of grant	Market price at date of award[1]	Number of RBS Shares[1]	Vesting date
RBS Group Long Term Incentive Plan[2] .	7 March 2011	4.45	401,309	7 March 2014[3]
2011 Buyout LTIP under the RBS Group Long Term Incentive Plan[2][4]	20 December 2011	1.97	229,505	Part vesting on each of 1 April 2012, 1 April 2013 and 1 April 2014[3]
RBS Group Deferral Plan	7 March 2011	4.45	100,991	7 March 2011–7 March 2014 (vesting in four tranches)
RBS Group UK Sharesave Plan	19 September 2011	2.33[5]	5,984	8 October 2016 or 8 October 2018

Notes:

(1) See Note (1) to paragraph 6.5 above.

(2) See Note (2) to paragraph 6.5 above.

(3) See Note (3) to paragraph 6.5 above.

(4) This is a specific award made to a Senior Manager in compensation for share-based remuneration forfeited at the time of joining the Company.

(5) Option exercise price.

6.9 The aggregate value, as at the date of acquisition, of RBS Shares acquired by Senior Management under RBS Group Employee Share Plans during the financial year ended December 2011 is £450,294. As at 31 December 2011 the Senior Management continued to hold, in aggregate, awards over 1,132,377 RBS Shares previously granted to them under RBS Group Employee Share Plans.

6.10 During the current financial year ending 31 December 2012, as employees of the RBS Group the Senior Managers were also granted, in aggregate, awards over RBS Shares under the RBS Group Employee Share Plans as set out below:

Share Plan	Date of grant	Market price at date of award[1]	Number of RBS Shares[1]	Vesting date
RBS Group Long Term Incentive Plan[2]	7 March 2012	2.80	937,306	7 March 2015[3]
2012 Buyout LTIP under the RBS Group Long Term Incentive Plan[2][4] .	15 March 2012	2.65	88,576	Part vesting on each of April 2012, 1 April 2013 and 1 April 2014[3]
RBS Group Deferral Plan	7 March 2012	2.80	209,701	7 March 2012–7 March 2015 (vesting in four tranches)

Notes:

(1) See Note (1) to paragraph 6.5 above.

(2) See Note (2) to paragraph 6.5 above.

(3) See Note (3) to paragraph 6.5 above.

(4) See note (4) to paragraph 6.8 above.

6.11 As at the latest practicable date prior to publication of this Prospectus, the aggregate value, as at the date of acquisition, of RBS Shares acquired by Senior Management under RBS Group Employee Share Plans during the current financial year ending 31 December 2012 is £964,412. As at the latest practicable date prior to publication of this Prospectus, the Senior Management continued to hold, in aggregate, awards over 2,234,647 RBS Shares previously granted to them under RBS Group Employee Share Plans.

6.12 There is no arrangement under which a Director or a Senior Manager has waived or agreed to waive future emoluments nor have there been any such waivers during the financial year immediately preceding the date of this Prospectus.

6.13 Other than in relation to the payment of premiums on the Group's products on an instalment basis, there are no outstanding loans or guarantees granted or provided by any member of the Group to, or for the benefit of, any of the Directors or the Senior Managers.

6.14 Other than as described in paragraph 6.1, no benefit, payment or compensation of any kind is payable to any Director of the Company upon termination of his or her employment.

7. DLG Share Plans

7.1 Employees (including Executive Directors and Senior Managers) continue to hold awards over RBS Shares granted prior to Admission by RBS, subject to the rules of the RBS Group Employee Share Plans. For Senior Managers and Executive Directors, awards granted in the financial years ended 31 December 2011 and ending 31 December 2012 under the RBS Group Long-Term Incentive Plan are summarised in paragraphs 6.5, 6.6, 6.8 and 6.10 above and will be satisfied by the transfer of Ordinary Shares from the Selling Shareholder to the award holder as summarised in Note (2) to Paragraph 6.5 above. No further grants will be made to employees of the Group under the RBS Group Employee Share Plans following Admission.

7.2 The Company will, following Admission, operate the DLG Long-Term Incentive Plan, the DLG Deferred Annual Incentive Plan and the DLG Share Incentive Plan. The terms of each of these employee share plans are summarised in paragraphs 7.3, 7.4 and 7.5 below.

The DLG Remuneration Committee intends to make awards under the DLG Long-Term Incentive Plan twice in each financial year of the Company (at approximately six month intervals following the announcement of the Company's annual and half-yearly results). For Mr. Geddes and Mr. Reizenstein, it is anticipated that such Awards will be over Ordinary Shares with a value of 100% of their then salary on each occasion. All awards will be made in accordance with the terms (including individual limits and vesting) of the DLG Long-Term Incentive Plan summarised in paragraph 7.3 below.

The first awards to be made within the twice-yearly grant cycle will be made within 40 days from Admission. These awards will be treated by the DLG Remuneration Committee as an ordinary award, consistent with awards that will usually be made in the second half of the Company's financial year. The value of awards to be granted within 40 days from Admission will be limited to 50% of the normal maximum permissible in respect of a financial year of the Company under the rules of the DLG Long-Term Incentive Plan. The awards to be granted within 40 days from Admission to Paul Geddes and John Reizenstein will be over Ordinary Shares with a value of 100% of their salary. The awards to be granted to the Senior Managers within 40 days from Admission will be over Ordinary Shares with lower multiples of their salaries than those applicable to the Executive Directors. No further awards will be made to Paul Geddes, John Reizenstein or the Senior Managers under the DLG Long-Term Incentive Plan during the financial year ending 31 December 2012.

These initial awards granted within 40 days from Admission will be subject to a total shareholder return ("**TSR**") condition as to 40% of the Ordinary Shares subject to the award and a return on tangible equity ("**ROTE**") condition as to 60% of the Ordinary Shares subject to the award. For these purposes, the Company's standard definition for ROTE will be used (adjusted profit after tax from ongoing operations divided by average tangible invested equity, and subject to such other adjustments as the DLG Remuneration Committee considers appropriate).

The ROTE condition will be measured over the 2013 and 2014 financial year of the Company and will require the average of the Company's annual ROTEs to be 14% for 20% of the portion of the award subject to the ROTE condition to vest, 15% for 40% to vest and 17% for the portion of the award subject to the ROTE condition to vest in full (with straight line vesting between these points).

The TSR condition will measure the Company's TSR relative to that of the constituents of the FTSE 350 (excluding investment trusts) over a three year period, beginning with the date of Admission. 20% of the portion of the award subject to the TSR condition will vest if the Company's TSR relative to the comparator group is at median, rising to 100% for TSR ranking in the upper quintile (with straight line vesting between these two points). The starting TSR will be measured over the period of one month following Admission and closing TSR will be measured over the last three months of the three year period.

In addition, the awards will only vest to the extent that the DLG Remuneration Committee is satisfied that the performance conditions outcomes reflect DLG's underlying financial performance over the period from the award date until vesting. The DLG Remuneration Committee will take into account whether there have been any material risk failings in making these considerations.

The DLG Remuneration Committee will keep the performance conditions for the DLG Long-Term Incentive Plan under review, to ensure that they remain appropriate. It is expected that the TSR and ROTE conditions will apply to grants in 2013 and that the ROTE condition will revert to a three year performance period for these awards.

The Executive Directors and Senior Managers are subject to Share Ownership Guidelines and are required to retain all of the Ordinary Shares that they obtain from any of the Company's employee share plans after any disposals necessary for the payment of personal taxes on the acquisition of such Ordinary Shares. For Paul Geddes, this requirement applies until such time as his holding of Ordinary Shares attains a value equal to two times base salary and for John Reizenstein, this applies until such time as his holding attains a value equal to one and a half times base salary. For Senior Managers, the intention is that they should retain Ordinary Shares until such time as an individual's holding of Ordinary Shares attains a value equal to one times base salary. For these purposes, the holding of Ordinary Shares will be treated as including all vested but unexercised awards, valued on a basis that is net of applicable personal taxes.

7.3 Summary of the DLG Long-Term Incentive Plan (the "LTIP")

General

The LTIP will enable selected employees of the Group (including Executive Directors) to be granted awards ("**Awards**") over Ordinary Shares. Awards granted under the LTIP are not transferable (except on death). Benefits under the LTIP are not pensionable benefits.

The DLG Remuneration Committee, which consists entirely of non-executive directors, will be responsible for the operation of the LTIP.

Awards granted under the LTIP will normally be granted as "nil-cost options" to acquire Ordinary Shares for no cost, although Awards may also be granted as conditional share awards or options with an exercise price. The vesting of Awards will be subject to performance conditions measured over a specified period. Awards under the LTIP may be satisfied by the issue of new Ordinary Shares, and by the transfer of Ordinary Shares held as treasury shares within the limits and restrictions set out below under "*Dilution Limits*" and/or by the transfer of Ordinary Shares (other than the transfer of treasury shares). Alternatively Awards may, at the discretion of the DLG Remuneration Committee, be settled in cash.

Eligibility

All employees of the Company and its subsidiaries (including Executive Directors) are eligible to participate in the LTIP at the discretion of the DLG Remuneration Committee.

Those employees holding an Award are referred to as "**Participants**".

Grants of Awards

Awards may be granted within 40 days following Admission. Thereafter Awards may only be granted:-

(a) in the period of six weeks beginning with the dealing day after the date on which the Company announces its annual or half-yearly results for any period; and

(b) at any other time when the DLG Remuneration Committee considers that the circumstances are sufficiently exceptional to justify the grant of Awards.

The grant of an Award will be subject to obtaining any approval or consent required under the Listing Rules, any relevant share dealing code of the Company, the City Code on Takeovers and Mergers, or any other UK or overseas regulation or enactment. In addition no Awards may be granted more than ten years from Admission.

Individual Limits

The maximum total market value of Ordinary Shares, over which Awards may be granted to any employee during any financial year of the Company is 200% of the employee's salary.

However, if the DLG Remuneration Committee decides that exceptional circumstances exist in relation to the recruitment or retention of an employee, then the maximum total market value of Ordinary Shares over which Awards may be granted to such employee during a financial year of the Company is 300% of that employee's salary measured at or around the date of grant.

For these purposes, the market value of Ordinary Shares will be the market value at or around the date of grant of an Award, but will not be calculated by reference to any period which is a prohibited period of the Company.

Dilution Limits

No Award may be granted under the LTIP if it would cause the number of Ordinary Shares issued or issuable under the Company's share plans in the preceding ten years to exceed 10% of the Company's issued ordinary share capital at that time. In addition, no Award may be granted under the LTIP if it would cause the number of Ordinary Shares issued or issuable under the LTIP or any other executive share plan in the preceding ten years to exceed 5% of the Company's issued ordinary share capital at that time.

The dilution limits exclude Awards which are satisfied by a transfer of existing Ordinary Shares. However, for as long as it is required by the Association of British Insurers guidelines, any transfer of Ordinary Shares held as treasury shares to satisfy Awards will be included in calculating the dilution limits.

Until such time as the Company ceases to be a major subsidiary undertaking (as that term is defined in the Listing Rules) of RBS, the Company will not issue new Ordinary Shares or transfer Ordinary Shares out of treasury to satisfy Awards.

Vesting of Awards

Awards will normally vest three years after they are granted (the "**Normal Vesting Period**") subject to the satisfaction of the applicable performance conditions. However, the vesting of Awards may be delayed in certain circumstances (such as where the Participant is subject to disciplinary action or the DLG Remuneration Committee is considering clawback).

Leaving Employment

If a Participant ceases employment with the Company's group, his or her Awards will normally lapse.

However, if the reason for a Participant ceasing employment is death, injury, disability, ill-health, redundancy, retirement (with the agreement of his or her employer), the Participant's employing business or company leaving the Group, or in other circumstances at the DLG Remuneration Committee's discretion, then the DLG Remuneration Committee may either:

(a) allow the Participant's outstanding Awards to be retained and to vest on the normal vesting date; or

(b) in exceptional cases, allow the Participant's outstanding Awards to vest on the date that the Participant ceased employment.

In either case, the number of Ordinary Shares over which each Award will vest will be determined by the DLG Remuneration Committee by (a) taking into account the extent to which the performance conditions and any other condition are considered to be satisfied; and (b) applying a pro rata reduction to the number of Shares determined by reference to (a), based on the period of time between the date the award was granted and the date of cessation of employment relative to the

Normal Vesting Period. The DLG Remuneration Committee will also have a discretion that can allow additional vesting by varying the application of the time pro-rating element of such calculation.

Where an individual retains an Award after ceasing employment but he engages in behaviour that is detrimental to the Group before the Award vests, the Award may lapse at the discretion of the DLG Remuneration Committee.

All Awards which are granted as options over Ordinary Shares must be exercised by the day before the tenth anniversary of the date on which that option over Ordinary Shares was granted. Any option over Ordinary Shares that vests further to a Participant ceasing to be employed with the Group must be exercised within 12 months of the vesting date of that Award (18 months in the case of death).

Takeover, Reconstruction etc.

In the event of a takeover, scheme of arrangement or winding-up of the Company, all outstanding Awards will vest as explained below. Comparable provisions may apply on a demerger, special dividend or similar event that materially affects the market value of the Ordinary Shares if the DLG Remuneration Committee considers it appropriate. However, in certain circumstances, the DLG Remuneration Committee may require Participants to rollover Awards on terms agreed with an acquiring company. Where Awards are to vest following a takeover or similar event, the Board shall notify Participants accordingly. Participants must exercise any Awards they have been granted as options over Ordinary Shares within one month of that notification and to the extent an option over Ordinary Shares has not been exercised during that period it will lapse.

The number of Ordinary Shares over which each Award will vest will be determined by the DLG Remuneration Committee by (a) taking into account the extent to which the performance condition and any other condition are considered to be satisfied; and (b) applying a pro rata reduction to the number of Shares determined by reference to (a), based on the period of time between the date the award was granted and the date of relevant notification relative to the Normal Vesting Period. The DLG Remuneration Committee will also have a discretion that can allow additional vesting by varying the application of the time pro-rating element of such calculation.

Variations of Capital

If there is a variation in the share capital of the Company, or the implementation of a demerger, the payment of a special dividend or a similar event that materially affects the market price of Ordinary Shares, the DLG Remuneration Committee may adjust the number of Ordinary Shares over which an Award has been granted.

Rights attaching to Shares

Awards will not confer any shareholder rights, such as the right to vote or to receive any dividend, prior to the record date on which the Ordinary Shares have been allotted or transferred to a Participant following the vesting of Awards.

A Participant will be entitled to receive a payment in additional Ordinary Shares when he or she receives the Ordinary Shares which have vested of an amount equivalent to any dividends payable in respect of those vested shares over the period from the date the award was granted until receipt of those vested shares (and assuming re-investment of dividends in further Ordinary Shares on the relevant ex-dividend dates).

Clawback

The DLG Remuneration Committee may decide at any time prior to the end of the Normal Vesting Period or within three years of the date on which an Award vests that the Participant, as the relevant individual to whom the Award was granted, shall be subject to clawback if:

(a) the DLG Remuneration Committee forms the view that the Company materially misstated its financial results for whatever reason and that such misstatement would have resulted or did in fact result, either directly or indirectly, in the relevant individual's Award vesting or being capable of vesting to a greater degree than would have been the case had that misstatement not been made;

(b) the DLG Remuneration Committee forms the view that, when it assesses the extent to which any Performance Condition and/or any other condition imposed in relation to an Award is satisfied or could be satisfied, that assessment was based on an error, or on inaccurate or misleading information or assumptions and that such error, information or assumptions would have resulted or did in fact result, either directly or indirectly in that Award vesting or being capable of vesting to a greater degree than would have been the case had that error not been made;

(c) the DLG Remuneration Committee forms the view that there are circumstances which would warrant the Company to summarily dismiss the relevant individual (whether or not the Company has chosen to do so) where such circumstances arose in the period from the grant of an Award until it vests;

(d) the DLG Remuneration Committee forms the view that the Company or the business unit in which the relevant individual works or worked suffered a material failure of risk management; or

(e) the DLG Remuneration Committee considers that something which occurred in the period from the grant of an award until the end of the Normal Vesting Period has a sufficiently significant impact on the reputation of the Group to justify the operation of clawback.

In pursuing a clawback, the DLG Remuneration Committee may seek to recoup the value received by the Participant pursuant to the LTIP by clawing-back such value from ongoing remuneration (including the Participant's next annual incentive award or unvested Awards) or directly by repayment from that Participant. The Company has the right to amend the circumstances when clawback may be applied to reflect any regulatory requirements which the Company may become subject to.

Amendments

The DLG Remuneration Committee may amend the LTIP or the terms of any Award granted under it. However, the provisions governing:

(a) eligibility requirements;

(b) individual limits on participation;

(c) overall limits on the issue of Ordinary Shares or the transfer of Ordinary Shares held as treasury shares;

(d) the basis for determining a Participants' entitlement to, and the terms of, Ordinary Shares and cash provided under the LTIP;

(e) the adjustments that may be made in the event of any variation of capital, and

(f) the amendment provisions,

cannot be altered to the advantage of Participants without the prior approval of the Company's shareholders in a general meeting.

However, there is an exception for minor amendments to benefit the administration of the LTIP, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for Participants or for any member of the Group.

In addition, the DLG Remuneration Committee may make any alteration relating to the performance conditions if an event has occurred which causes the DLG Remuneration Committee reasonably to consider that it would be appropriate to amend the performance conditions, and the altered performance conditions would, in the reasonable opinion of the DLG Remuneration Committee be not materially less difficult to satisfy than the unaltered performance conditions would have been but for the event in question, and the DLG Remuneration Committee acts fairly and reasonably in making the alteration.

Overseas Participants

The Board also has authority to establish schedules amending the LTIP and/or further sub-plans based on the LTIP to enable the LTIP to operate in jurisdictions outside the UK.

7.4 Summary of the DLG Deferred Annual Incentive Plan ("DAIP")

General

The DAIP is a share plan under which selected Executive Directors and employees of the Group who receive an annual incentive award in respect of a financial year under the Company's normal annual incentive plan or who receive an annual incentive award in respect of the year ending 31 December 2012, may be awarded part of their total annual incentive award outcome for that year in the form of options granted as nil-cost options over Ordinary Shares ("**Deferred Share Awards**") at the discretion of the DLG Remuneration Committee. As explained at paragraph 6 above, the current intention is, in respect of senior employees, for 40% of their annual incentive outcome to be delivered as Deferred Share Awards under the DAIP and for 60% to be paid out in cash.

Deferred Share Awards granted under the DAIP are not transferable (except on death). Benefits under the DAIP are not pensionable benefits.

The DLG Remuneration Committee will be responsible for the operation of the DAIP.

Deferred Share Awards may be satisfied by the issue of new Ordinary Shares, and by the transfer of Ordinary Shares held as treasury shares within the limits and restrictions set out below under "*Dilution Limits*" and/or by the transfer of Ordinary Shares (other than the transfer of treasury shares). Alternatively Deferred Share Awards may, at the discretion of the DLG Remuneration Committee, be settled in cash.

Eligibility

To be eligible to receive a Deferred Share Award an individual must (i) be an employee (which can include any Executive Director) or (ii) a former employee of the Company or any of its subsidiaries who in either case has achieved an annual incentive award for the preceding financial year of the Company.

Those employees holding a Deferred Share Award under the DAIP are referred to as "**Participants**".

Grants of Awards

Deferred Share Awards under the DAIP may only be granted:

(a) in the six week period beginning with the dealing day following the announcement by the Company of its results for the financial year relating to the annual incentive outcome; or

(b) at any other time when the circumstances are considered by the DLG Remuneration Committee to be sufficiently exceptional to justify their grant.

The grant of Deferred Share Awards will be subject to obtaining any approval or consent required under the Listing Rules, any relevant share dealing code of the Company, the City Code on Takeovers and Mergers or any other applicable UK or overseas regulation or enactment. In addition, no Deferred Share Awards may be granted more than ten years from Admission.

Calculation of number of Ordinary Shares under a Participant's Deferred Share Award

The Deferred Share Award will be granted over such whole number of Ordinary Shares that is calculated by dividing the amount equal to the percentage of the annual incentive outcome to be delivered under the DAIP by the market value of an Ordinary Share at or around the date of grant of the Deferred Share Award.

The market value of an Ordinary Share will not be calculated by reference to any period which is a prohibited period of the Company.

Dilution Limits

No Award may be granted under the DAIP if it would cause the number of Ordinary Shares issued or issuable under the Company's share plans in the preceding ten years to exceed 10% of the Company's issued ordinary share capital at that time. In addition, no Award may be granted under the DAIP if it would cause the number of Ordinary Shares issued or issuable under the DAIP or any other executive share plan in the preceding ten years to exceed 5% of the Company's issued ordinary share capital at that time.

The dilution limits exclude Deferred Share Awards which are satisfied by a transfer of existing Ordinary Shares. However, for as long as it is required by the Association of British Insurers guidelines, any transfer of Ordinary Shares held as treasury shares to satisfy Deferred Share Awards will be included in calculating the dilution limits.

Until such time as the Company ceases to be a major subsidiary undertaking (as that term is defined in the Listing Rules) of RBS, the Company will not issue new Ordinary Shares or transfer Ordinary Shares out of treasury to satisfy Deferred Share Awards.

Vesting of Deferred Share Awards

Deferred Share Awards will normally vest on the third anniversary of the date of grant (the "**Normal Vesting Period**"). Once vested, a Deferred Share Award will normally remain capable of exercise until the day preceding the tenth anniversary of its grant. The vesting of Awards may be delayed in certain circumstances (such as where the Participant is subject to disciplinary action or the DLG Remuneration Committee is considering clawback).

Leaving Employment

If a Participant gives notice of his resignation with the DLG group prior to the vesting date or if he or she is dismissed for cause, the Participant's Deferred Share Awards will lapse unless (in the case of resignation only) the DLG Remuneration Committee determines otherwise. However, in other circumstances where the Participant's employment ceases prior to the vesting date (or where the DLG Remuneration Committee exercises its discretion for the Deferred Share Award not to lapse in the case of resignation), then the DLG Remuneration Committee may either:

(a) allow the Participant's outstanding Deferred Share Awards to be retained and to vest on the normal vesting date; or

(b) in exceptional cases, allow the Participant's outstanding Deferred Share Awards to vest on the date that the Participant ceased employment.

In either case, the period for exercising such Deferred Share Awards will end 12 months from the date when the Deferred Share Award vested and became capable of exercise (or such earlier date as the DLG Remuneration Committee decides at or shortly after the Participant's cessation of employment).

Where an individual retains an Award after ceasing employment but he engages in behaviour that is detrimental to the Group before the Award vests, the Award may lapse at the discretion of the DLG Remuneration Committee.

Takeover, Reconstruction etc

In the event of a takeover of the Company, a scheme of arrangement or winding-up of the Company, all outstanding Deferred Share Awards will vest and the Board shall notify Participants accordingly. Participants must exercise any Deferred Share Awards within one month of that notification and to the extent not exercised during that period, they will lapse. Comparable provisions may apply on a demerger, special dividend or similar event that materially affects the market value of the Ordinary Shares if the DLG Remuneration Committee considers it appropriate.

Variations of Capital

If there is a variation in the share capital of the Company, or the implementation of a demerger, or the payment of a special dividend or a similar event that materially affects the market price of the Ordinary Shares the DLG Remuneration Committee may adjust the number of Ordinary Shares over which a Deferred Share Award has been granted.

Rights attaching to Shares

Deferred Share Awards will not confer any shareholder rights, such as the right to vote in relation to the Ordinary Shares or to receive any dividend, prior to the record date on which the Ordinary Shares have been allotted or transferred to the Participant.

The number of Ordinary Shares subject to Deferred Share Awards will be increased to take account of dividends awarded in respect of those Ordinary Shares on the same basis as described for the LTIP in paragraph 7.3 above.

Clawback

The DLG Remuneration Committee may decide at any time prior to the end of the Normal Vesting Period or within three years of the date on which a Deferred Share Award vests that the Participant, as the relevant individual to whom the Deferred Share Award was granted, shall be subject to clawback if:

(a) the DLG Remuneration Committee forms the view that the Company materially misstated its financial results for whatever reason and that such misstatement would result or did in fact result, either directly or indirectly in the relevant individual's Deferred Share Award being granted or in the Deferred Share Award vesting or being capable of vesting to a greater degree than would have been the case had that misstatement not been made;

(b) the DLG Remuneration Committee forms the view that, when it assessed the extent to which any performance condition in relation to the relevant individual's annual incentive award was satisfied, that assessment was based on an error, or on inaccurate or misleading information or assumptions and that such error, information or assumptions would result or did in fact result, either directly or indirectly in that Deferred Share Award being granted or vesting or being capable of vesting to a greater degree than would have been the case had that error not been made;

(c) the DLG Remuneration Committee forms the view that there are circumstances which would warrant the Company to summarily dismiss that relevant individual (whether or not the Company has chosen to do so) where such circumstances arose in the period from the grant of an Award until it vests;

(d) the DLG Remuneration Committee forms the view that the Company or the business unit in which the relevant individual works or worked suffered a material failure of risk management; or

(e) the DLG Remuneration Committee considers that something which occurred in the relevant financial year in respect of which the Deferred Share Award was earned has a sufficiently significant impact on the reputation of the Group to justify the operation of clawback.

In pursuing a clawback, the DLG Remuneration Committee may seek to recoup the value received by the Participant pursuant to the DAIP by clawing-back such value from ongoing remuneration (including the Participant's next annual incentive award or unvested Deferred Share Awards) or directly by repayment from that Participant. The Company has the right to amend the circumstances when clawback may be applied to reflect any regulatory requirements which the Company may become subject to.

Amendments

The DLG Remuneration Committee may amend the DAIP or the terms of any Deferred Share Award granted under it. However, the provisions governing:

(a) eligibility requirements;

(b) individual limits on participation;

(c) overall limits on the issue of Ordinary Shares or the transfer of Ordinary Shares held as treasury shares;

(d) the basis for determining a Participants' entitlement to, and the terms of, Ordinary Shares provided under the DAIP;

(e) the adjustments that may be in the event of any variation of capital; and

(f) the amendment provisions,

cannot be altered to the advantage of Participants without the prior approval of the Company's shareholders in a general meeting.

However, there is an exception for minor amendments to benefit the administration of the DAIP, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for Participants or for any member of the Group.

Overseas Participants

Additionally, the Board also has authority to establish schedules amending the DAIP and/or further sub-plans based on the DAIP to enable the DAIP to operate in jurisdictions outside the UK on the same basis as described above for LTIP.

7.5 Summary of the principal features of the DLG Share Incentive Plan (the "SIP")

Introduction

A summary of the main features of the SIP is set out below. An application will be made to HM Revenue and Customs ("**HMRC**") for formal approval of the SIP under the provisions of Schedule 2 to the Income Tax (Earnings and Pensions) Act 2003.

The SIP will be operated at the discretion of the DLG Remuneration Committee.

Eligibility

All UK resident tax-paying employees of the Company and its participating subsidiaries (which have agreed to be bound by the terms of the SIP) ("**Participating Subsidiaries**") who have been employed for a minimum period (not exceeding 18 months) will be eligible to participate in the SIP with certain limited exceptions (including that an employee must not participate in any other such HMRC approved share incentive plan at the same time) ("**Eligible Employees**").

Outline

The Company may offer any combination of the features outlined below. Under the SIP, the Company can:

(a) award up to £3,000 worth of free Ordinary Shares in each tax year to each Eligible Employee ("**Free Shares**");

(b) offer Eligible Employees the opportunity of buying up to the lower of £1,500 and 10% of their salary in Ordinary Shares in each tax year ("**Partnership Shares**");

(c) make an award to those employees who have invested in Partnership Shares of up to two free matching Ordinary Shares for each Partnership Share acquired ("**Matching Shares**") (Free Shares, Partnership Shares and Matching Shares together being the "**Plan Shares**"); and

require or allow Eligible Employees to acquire additional Ordinary Shares ("**Dividend Shares**") using dividends received on Plan Shares up to an annual limit of £1,500 in each tax year.

The limits mentioned above in relation to Partnership Shares, Free Shares, Matching Shares and Dividend Shares may be increased to reflect any higher limit as is permitted under any future amendment to the share incentive plan legislation.

Those Eligible Employees holding an award of Plan Shares are known as participants ("**Participants**").

Free Shares

Up to £3,000 worth of Free Shares can be awarded to each Eligible Employee in each tax year. An award of Free Shares on the same terms, may be nevertheless directly proportional to a Participant's remuneration, length of service or number of hours worked with a Participating Subsidiary. The award of Free Shares can, if the Company so chooses, be subject to the satisfaction of performance targets.

There is a holding period of not less than three and not more than five years during which the Participant cannot withdraw the Free Shares from the SIP unless the Participant ceases to be employed by the Company or one of its associated companies ("**Relevant Employment**") in certain circumstances. The Company can, at its discretion, provide that the Free Shares will be forfeited if the Participant ceases to be in Relevant Employment other than by reason of injury, disability, redundancy, the transfer of the employing business or company, retirement on or after reaching

retirement age or death. Forfeiture can only take place within three years of the Free Shares being awarded.

It is intended that on or around the time of Admission an award of Free Shares to the value of £250 per employee will be made to all Eligible Employees (regardless of remuneration, length of service, hours worked or any other consideration). Participants will be required to hold the Shares in the SIP for a period of three years unless there is a cessation of Relevant Employment prior to the end of that period. Where there is a cessation of Relevant Employment within this three year period then the Free Shares will be forfeit unless this cessation is by reason of injury, disability, redundancy, the transfer of the employing business or company, retirement on or after reaching retirement age or death in which case the Participant (or his estate as the case may be) will retain the Free Shares awarded.

Partnership Shares

The Company may provide Eligible Employees with the opportunity to use pre tax salary to acquire Partnership Shares. The maximum limit is the lower of £1,500 or 10% of an Eligible Employee's salary in any tax year. The Company may set a minimum monthly deduction from salary which may not be greater than £10 and which will be used to acquire Ordinary Shares within 30 days after each deduction. Alternatively, deductions can be accumulated during an accumulation period of up to 12 months, in which case Ordinary Shares will be acquired on behalf of employees within 30 days after the end of the accumulation period. Once acquired, employees may withdraw Partnership Shares from the SIP at any time and these will not be capable of forfeiture.

Matching Shares

The Company may award Matching Shares for free to employees who have acquired Partnership Shares. If awarded, Matching Shares must be awarded on the basis of up to a maximum of two Matching Shares for every Partnership Share acquired (or such other maximum as may be permitted by statute) and with the same ratio used for all employees. There is a holding period of not less than three and not more than five years during which the Participant cannot withdraw the Matching Shares from the SIP unless the Participant ceases to be in Relevant Employment in certain circumstances. If a Participant withdraws Partnership Shares within the applicable forfeiture period (which period cannot exceed three years) the Participant's entitlement to Matching Shares will lapse immediately, unless there is a cessation of Relevant Employment by reason of injury, disability, redundancy, the transfer of the employing business or company, retirement on or after reaching retirement age or death. The Company can, at its discretion, provide that the Matching Shares will be forfeited if a Participant ceases to be in Relevant Employment other than by reason of injury, disability, redundancy, the transfer of the employing business or company, retirement on or after reaching retirement age or death. Forfeiture can only take place within the forfeiture period (which cannot exceed three years) of the Matching Shares being awarded.

Investment of dividends into Dividend Shares

The Company may at its discretion direct that all cash dividends paid in respect of Plan Shares held by Participants must be used to acquire further Ordinary Shares or may, at the Participant's election, be used to acquire further Ordinary Shares, provided that the amount so reinvested in Dividend Shares cannot exceed £1,500 each tax year. Dividend Shares must be held in the SIP for three years, unless the Participant ceases to be in Relevant Employment. Once acquired, Dividend Shares are not capable of forfeiture.

SIP Trust

The SIP is operated through a trust resident in England and Wales ("**SIP Trust**"). The SIP Trust acquires Ordinary Shares that are subsequently awarded to employees in accordance with the terms of the SIP. The money to buy shares will be provided either by the Company or its Participating Subsidiaries or, in relation to Partnership Shares, by employees.

The SIP Trust has agreed to acquire £3,675,000 worth of Ordinary Shares from the Selling Shareholder at the Offer Price, conditional only on Admission, in order that it may satisfy the awards of Free Shares to be made on or around Admission.

Limits on issue of Ordinary Shares

The SIP contains a limit on the number of Ordinary Shares to be issued pursuant to the SIP. This dilution limit is that no more than 10% of the issued ordinary share capital of the Company, from time to time, may be issued or is issuable under the Company's share plans (including the SIP) in any rolling ten year period.

The dilution limits exclude Awards which are satisfied by a transfer of existing Ordinary Shares. Any transfer of Ordinary Shares held as treasury shares to satisfy Awards will be included in calculating the dilution limits.

Until such time as the Company ceases to be a major subsidiary undertaking (as that term is defined in the Listing Rules) of RBS, the Company will not issue new Ordinary Shares or transfer Ordinary Shares out of treasury to satisfy awards under the SIP.

Awards non-pensionable

Awards under the SIP are not pensionable, although any salary used to purchase Partnership Shares will continue to be treated as pensionable income so as not to disadvantage employees who decide to use part of their salary to purchase such shares.

Amendments to the rules of the SIP

The Company may from time to time amend the rules of the SIP provided that:

(a) the prior approval of the Company in a general meeting is obtained for amendments made to the advantage of existing or future Eligible Employees relating to:

   (i) the basis for determining an Eligible Employee's entitlement (or otherwise) to receive an award of Plan Shares and/or entitlement (or otherwise) to Dividend Shares and/or to become absolutely entitled (or otherwise) to Plan Shares subject to an award and/or Dividend Shares under the SIP;

   (ii) the persons to whom an award may be made;

   (iii) the limit on the number of Ordinary Shares available under the SIP;

   (iv) the limit on the number or value of shares over which awards may be made or may be acquired as Dividend Shares by each employee;

   (v) the price (if any) payable for Ordinary Shares by Eligible Employees;

   (vi) the provisions affecting variations of share capital; and

   (vii) the amendment provisions,

   except for minor amendments to benefit the administration of the SIP, to take account of changes in legislation and amendments to obtain or maintain favourable tax, exchange control or regulatory treatment for the Eligible Employees or for the Company or its participating subsidiaries).

(b) no modification shall alter to the disadvantage of any Participant his accrued rights under the SIP;

(c) no modification shall modify or alter to the disadvantage of the Trustee of the SIP Trust the provisions for its protection and indemnity without the Trustee's written agreement;

(d) while the SIP is approved by HMRC, no modification shall be made to a key feature of the SIP without HMRC consent; and

(e) no modification shall be made which would cause a breach of the rule against perpetuities or would cause the SIP to cease to be an employees' share scheme (within the meaning of the Companies Act).

7.6 Summary of the principal features of the Direct Line Insurance Group plc International Share Incentive Plan (the "International SIP")

Introduction

The International SIP is intended to permit the Company to offer awards to employees who are not eligible to participate in the SIP—in practice it is expected to be applied for use with employees who are working in countries other than the UK. The rules are similar to Rules of the SIP and the main areas of difference are described below.

No application for formal approval of the International SIP will be made to HMRC.

Eligibility

The persons eligible to participate in the International SIP ("**International Eligible Employees**") are similar to the SIP except that it excludes those employees who are eligible to participate in the SIP.

Those International Eligible Employees holding an award under the International SIP are known as participants ("**Participants**").

Outline

The awards the Company may offer an International Eligible Employee under the International SIP are in outline similar to the awards the Company may offer under the SIP save that:

(a) instead of Free Shares the Company can offer a free shares incentive award—(being an award under which Participants will only receive the beneficial entitlement to Free Shares at the end of the holding period for those Free Shares) worth up to £3,000 (a "**Free Shares Incentive Award**"); and

(b) instead of Matching Shares the Company can offer a matching shares incentive award, (being a right to up to two Matching Shares for each Partnership Share acquired where the Participant will only receive the beneficial entitlement to the Matching Shares at the end of the holding period for those Matching Shares) (a "**Matching Shares Incentive Award**").

Free Shares and Free Shares Incentive Award

A Free Share Award may be made under the International SIP on the same basis as a Free Share Award under the SIP except that the Directors may choose to make either a Free Shares Incentive Award or a Free Share Award (in either case, referred to in this summary as an "**Award**") to take into account any relevant overseas tax or legal requirements.

Where a Free Shares Incentive Award is made then the Free Shares will be transferred to the Participant at the end of a period of not less than three and not more than five years unless the Participant ceases to be employed by the Company or one of its associated companies in certain circumstances. A Free Shares Incentive Award may be forfeit on a cessation of Relevant Employment in the same manner as an award of Free Shares.

It is intended that on or around the time of Admission all International Eligible Employees will receive either a Free Share Award or a Free Shares Incentive Award (regardless of remuneration, length of service, hours worked or any other consideration). Each Award made to an Eligible Employee will be over shares to the value of £250, calculated by reference to market value at grant. At the end of a period of three years the Free Shares will be transferred to the Participant. Where there is a cessation of Relevant Employment prior to the end of this three year period the Award will lapse (though this is subject to an exception where this cessation is by reason of injury, disability, redundancy, the transfer of the employing business or company, retirement on or after reaching retirement age or death in which case the Award will not lapse and the Free Shares will be transferred to the Participant or his estate as the case may be).

Partnership Shares

An International Eligible Employee may acquire Partnership Shares under the International SIP in the same manner as the SIP and subject to the same limitations except that the purchase of any Partnership Shares will be funded by the Participant from his net salary.

Matching Shares

Matching Shares may be awarded under the International SIP on the same basis as Matching Shares may be awarded under the SIP except that the Directors may choose to make a Matching Shares Incentive Award.

Where a Matching Shares Incentive Award is made, this will be on the basis of a right to up to two Matching Shares for each Partnership Share acquired.

The Matching Shares will be transferred to the Participant at the end of a period of not less than three and not more than five years unless the Participant ceases to be employed by the Company or one of its associated companies in certain circumstances.

If a Participant withdraws Partnership Shares within the applicable forfeiture period (which cannot exceed three years) then the Participant's Matching Shares Incentive Award will lapse immediately unless there is a cessation of Relevant Employment by reason of injury, disability, redundancy, the transfer of the employing business or company, retirement on or reaching retirement age or death. The Company can also provide that the Matching Shares Incentive Award will be forfeit on the Participant ceasing to be in Relevant Employment subject to the same exceptions and qualifications that would apply if the Participant had been in receipt of an award of Matching Shares.

International SIP trust

The International SIP will be administered through a trust resident in Jersey (the "**International SIP Trust**"—see paragraph below headed "Summary of the Principal Features of the Direct Line Insurance Group Employee Benefit Trust (the **EBT**)". The International SIP Trust may acquire Ordinary Shares with funding provided by the Company or its subsidiaries that are subsequently awarded to employees in accordance with the terms of the International SIP.

The International SIP Trust has agreed to acquire £325,000 worth of Ordinary Shares from the Selling Shareholder at the Offer Price, conditional only on Admission, in order that it may satisfy Free Share Awards and Free Share Incentive Awards to be made on or around Admission.

Limits on issue of Ordinary Shares

The International SIP is subject to the same limits and restrictions in respect of the number of Ordinary Shares as those applying to the SIP.

Awards not pensionable

Awards under the International SIP are not pensionable in the same way as the SIP.

Amendments to the rules of the International SIP

The Company may from time to time amend the rules of the International SIP in the same way and subject to the same qualifications as the SIP except that:

(a) there is no qualification that there shall be no amendment to the provisions relating to the protection and indemnity of the trustee without the written agreement of the trustee;

(b) there is no necessity to secure the consent of HMRC to any modification; and

(c) there is no qualification that there may be no amendment to the International SIP which might cause a breach of the rule against perpetuities or might result in the International SIP ceasing to be an "employee share scheme" (within the meaning of the Companies Act).

7.7 Summary of the principal features of the Direct Line Insurance Group Employee Benefit Trust (the "EBT")

The Company has appointed a company resident in Jersey as the trustee of a discretionary trust for the benefit of employees, former employees and certain of their family (the "**Beneficiaries**"). The trustee has broad discretionary powers to act for the benefit of Beneficiaries.

The EBT will, amongst other matters, act as the International SIP Trust (see paragraph headed "International SIP Trust"). The EBT may also acquire Ordinary Shares as appropriate to satisfy awards under the Company's employee share plans (other than the SIP). Unless otherwise approved

by the Company in a general meeting, the number of Ordinary Shares held by the EBT at any one time shall not exceed 5% of the issued ordinary share capital of the Company at that time. Until such time as the Company ceases to be a major subsidiary undertaking (as that term is defined in the Listing Rules) of RBS, the Company will not issue new Ordinary Shares or transfer Ordinary Shares out of treasury to the EBT.

Funding of the EBT will be provided by the Company or its subsidiaries.

The EBT has agreed to acquire £1,000,000 worth of Ordinary Shares from the Selling Shareholder at the Offer Price, conditional only on Admission, in order that it may satisfy awards to be made under the LTIP within 40 days of Admission.

8. Pension Schemes

8.1 Summary of UK pension benefits

The Group operates defined benefit and defined contribution pension plans in the UK and overseas. The UK defined benefit scheme, the Direct Line Group Closed Pension Scheme, is closed to new entrants and no further benefits are accruing under it.

Direct Line Group Closed Pension Scheme (DLG Pension Scheme)

The DLG Pension Scheme provides both defined benefit and defined contribution benefits for its members, who are current or former staff of DLISL and Green Flag Group Limited. The DLG Pension Scheme is primarily a defined benefit scheme, but contains a defined contribution element with certain minimum pension underpins in respect of its members' benefits. As at 30 September 2011, the DLG Pension Scheme had 2,347 members. There are no members continuing to accrue benefits under the DLG Pension Scheme as the future accrual of benefits ended on 30 September 2001.

RBS Insurance Pension Scheme

The RBS Insurance Pension Scheme is a defined contribution scheme. The scheme provides benefits for employees of DLISL. It closed to new members on 1 October 2007 but benefits continue to accrue under it for existing members. (On the closure of the scheme to new members, alternative pensions arrangements were put in place for employees of DLISL through an RBS Group scheme). As at 30 September 2011, the RBS Insurance Pension Scheme had 21,271 members. The employer contributions paid by DLISL range from 2% of basic salary up to 36% for certain executives.

Direct Line Group Personal Pension Plan

The Direct Line Group Personal Pension Plan was established on 1 June 2012. The plan is provided by Fidelity and membership of the plan is open to all Direct Line Group employees. The default company contribution rate is 9% of members' basic salary, but members have the option to reduce this down to a minimum of 1% or to opt out altogether, in return for a payment in lieu through payroll. Members may choose to make additional contributions via a salary sacrifice arrangement.

Provision for UK pension costs

The defined benefit and defined contribution pension arrangements in the UK are separately funded through trust arrangements or contracts of insurance.

The latest formal valuation of the DLG Pension Scheme was carried out as at 1 October 2011. This valuation reported assets at a total market value of £53.5 million, liabilities of £66.5 million and a funding deficit of £13 million, calculated on the statutory funding basis. As a result of the valuation, a schedule of contributions is due to be agreed between DL Insurance Services Limited, as principal employer of the scheme, and the scheme trustee to reduce the scheme deficit. DL Insurance Services Limited has agreed in principle with the scheme trustee that under the new schedule of contributions it will make annual payments to the scheme of £2.786 million for 4 years from 31 March 2013. Under the previous schedule of contributions agreed as a result of the 2008 actuarial valuation, DL Insurance Services Limited made annual contributions of between £2.51 million and £2.82 million from 31 March 2009 to 31 March 2012 to reduce the scheme deficit.

The benefits provided from the defined contribution arrangements (RBS Insurance Pension Scheme and the Direct Line Group Personal Pension Plan) are provided entirely from contributions made to those arrangements and the investment returns on those contributions.

8.2 The total pension amounts set aside for the Directors and Senior Managers for the year ending 31 December 2011 was £398,000 in respect of defined benefit arrangements (measured as the change in transfer value over the year) and £165,300 in respect of defined contribution arrangements (measured as the employer contributions over the year).

8.3 Summary of overseas pension benefits

In Italy, the Group operates a company defined contribution pension fund. In Germany, the Group operates a small, unfounded defined benefit pension scheme. The Group also provides other small arrangements in Germany, which are defined contribution in nature.

9. Significant Subsidiary and Associated Undertakings

The Company is the principal operating and holding company of the Group.

The significant subsidiary undertakings and associated undertakings of the Company are as follows:

Name and country of incorporation/ residence		Class of share capital (issued and fully paid, unless otherwise stated)	Proportion of capital held	Proportion of voting power held (if different from capital held)	Principal activity
Direct Line Insurance S.p.A. . .	Italy	Ordinary	100%	100%	General Insurance
DL Insurance Services Limited	Great Britain	Ordinary	100%	100%	Management Services
U K Insurance Limited	Great Britain	Ordinary	100%	100%	General Insurance
Direct Line Versicherung AG .	Germany	Registered	100%	100%	General Insurance

10. Properties, Investments, Assets

The following are the principal establishments of the Group:

Name and location	Type of facility	Tenure
Churchill Court . . . . . . Westmoreland Road Bromley BR1 1DP United Kingdom	Office	Leasehold
37 Broad Street . . . . . . Bristol BS99 7NQ United Kingdom	Office	Leasehold
Green Flag House . . . . . . Cote Lane Pudsey West Yorkshire LS28 5GF United Kingdom	Office	Leasehold
Direct Line House . . . . . . The Headrow Leeds LS1 8HZ United Kingdom	Office	Leasehold
The Mere . . . . . . Lakeside Boulevard Doncaster DN4 5PL United Kingdom	Office	Leasehold

Name and location	Type of facility	Tenure
Cavern Court Mathew Street Liverpool L2 6RE United Kingdom	Office	Leasehold
The Wharf Neville Street Leeds LS1 4AZ United Kingdom	Office	Leasehold
Direct Line House 14-18 Cadogan Street Glasgow G2 6QN United Kingdom	Office	Leasehold
Unit 15-36 Stechford Retail Park Flaxley Park Way Flaxley Road Stechford Birmingham B33 9AL United Kingdom	Accident Repair Centre	Freehold
Direct Line House 10 Livery Street Birmingham B3 2NU United Kingdom	Office	Leasehold
Direct Line House 17 Quay Street Manchester M3 3HN United Kingdom	Office	Leasehold
60 Cunningham Road Rutherglen Glasgow G73 1PP United Kingdom	Accident Repair Centre	Leasehold
Via Fratelli Gracchi 30/32 Cinisello Balsamo Milan Italy	Office	Leasehold
Piazza Monte Titano 10 Lambrate Milan Italy	Office	Leasehold
Rheinstrasse 7A 14513 Teltow Berlin Germany	Office	Leasehold

10.1 No single tangible fixed asset (including property, plants and equipment) accounts for more than 10% of the Group's net turnover or production.

11. Underwriting Arrangements

11.1 The Company, the Directors, the Selling Shareholder and the Banks have entered into the Underwriting Agreement, together with a side agreement relating to the commissions payable to the Institutional Offer Underwriters, as referred to below. Pursuant to the terms of these underwriting arrangements:

(a) the Selling Shareholder has agreed, subject to certain conditions, to sell the Ordinary Shares in the Offer at the Offer Price;

(b) the Institutional Offer Underwriters have agreed, subject to certain conditions, to procure purchasers for (or to the extent that purchasers fail to be so procured, or to the extent such purchasers fail to purchase all of the Institutional Offer Shares, to purchase themselves in their agreed proportions) the Institutional Offer Shares offered pursuant to the Institutional Offer at the Offer Price;

(c) the Intermediaries Offer Underwriter has agreed, subject to certain conditions, to procure that the Intermediaries purchase (or to the extent such Intermediaries fail to purchase all of the Intermediaries Offer Shares, to purchase itself) the Intermediaries Offer Shares at the Offer Price;

(d) the Selling Shareholder has agreed that the Institutional Offer Underwriters may, subject to certain conditions being satisfied, deduct from the proceeds of the Institutional Offer a commission of 1.75% of the product of the Offer Price and the number of Institutional Offer Shares sold pursuant to the Institutional Offer (together with any Ordinary Shares sold pursuant to any exercise of the Over-allotment Option), together with any applicable value added tax. The Selling Shareholder has also agreed, in its absolute discretion, to pay a discretionary commission to some or all of the Institutional Offer Underwriters of up to 0.85% of the product of the Offer Price and the number of Institutional Offer Shares sold pursuant to the Institutional Offer (together with any Ordinary Shares sold pursuant to any exercise of the Over-allotment Option), together with any applicable value added tax;

(e) the Selling Shareholder has agreed that the Intermediaries Offer Underwriter may, subject to certain conditions being satisfied, deduct from the proceeds of the Intermediaries Offer a commission of 0.4% of the product of the Offer Price and the number of Intermediaries Offer Shares sold pursuant to the Intermediaries Offer (provided that this commission shall be subject to a maximum amount of £800,000), together with any applicable value added tax;

(f) the obligations of (i) the Institutional Offer Underwriters to procure purchasers for or, failing which, themselves to purchase, Ordinary Shares, and (ii) the Intermediaries Offer Underwriter to procure that the Intermediaries purchase or, failing which, itself to purchase, Ordinary Shares, in each case on the terms of the Underwriting Agreement, will be subject to certain conditions that are customary for an agreement of this nature. These conditions include, amongst other things, delivery of customary comfort packages, the absence of a material adverse change in relation to the Company and the market and approval of various offering documents having been received. In addition, the obligations of the Underwriters are conditional upon the Relationship Agreement, the TSA, the Separation Agreement and the Tax Cooperation Agreement having been entered into and becoming unconditional;

(g) the Selling Shareholder has granted the Stabilising Manager (on behalf of the Institutional Offer Underwriters) the Over-allotment Option, pursuant to which the Stabilising Manager may require the Selling Shareholder to make available additional Ordinary Shares of up to 15% of the aggregate number of Ordinary Shares available in the Offer (before any exercise of the Over-allotment Option) at the Offer Price to cover over-allotments, if any, made in connection with the Offer. The Over-allotment Option may be exercised, in whole or in part, at any time during the period from the commencement of conditional dealings of Ordinary Shares on the London Stock Exchange and ending 30 calendar days thereafter. Save as required by law, the Stabilising Manager does not intend to disclose the extent of any over-allotments made and/or any stabilisation transactions carried out;

(h) the Selling Shareholder and the Company have each agreed to pay or cause to be paid (together with any applicable VAT) certain costs, charges, fees and expenses of or arising in connection with, or incidental to, the Offer;

(i) the Company, the Directors and, on a limited basis, the Selling Shareholder have each given customary representations, warranties and undertakings to the Banks and the Company and, on a limited basis, the Selling Shareholder have given customary indemnities to the Banks. The liabilities of the Directors and the Selling Shareholder under the Underwriting Agreement are limited as to time or amount. The limits on liability will apply to any claims made under the Underwriting Agreement, other than where the claims relate to authority and capacity to enter into the Underwriting Agreement, title to the Ordinary Shares and compliance with certain laws and regulations;

(j) the parties to the Underwriting Agreement have given certain covenants to each other regarding compliance with laws and regulations affecting the making of the Offer in relevant jurisdictions;

(k) the Company has entered into certain lock-up arrangements relating to securities of the Company that are substantially similar to the Ordinary Shares (including, but not limited to, any securities that are convertible into or exchangeable for, or that represent the right to receive, Ordinary Shares or any such substantially similar securities). The Company has agreed that, subject to certain exceptions, during the period of 180 days from the date of Admission, it will not, without the prior written consent of the Joint Sponsors and the Joint Global Coordinators, issue, lend, mortgage, assign, charge, offer, sell or contract to sell, or otherwise dispose of any Ordinary Shares (or any interest therein or in respect thereof) or enter into any transaction with the same economic effect as any of the foregoing;

(l) each of the Directors has entered into certain lock-up arrangements relating to Ordinary Shares. Each of the Directors has agreed that, subject to certain exceptions, during the period from 360 days from the date of Admission, he/she will not offer, sell or contract to sell, grant or sell any option over, charge, pledge or otherwise dispose of any Ordinary Shares (or any interest therein or in respect thereof) or enter into any transaction with the same economic effect as any of the foregoing; and

(m) the Selling Shareholder has agreed that, subject to certain exceptions, during the period of 180 days from the date of Admission, it will not sell or contract to sell, grant or sell any option over, charge, pledge or otherwise dispose of any Ordinary Shares (or any interest therein in respect thereof) or enter into any transaction with the same economic effect as any of the foregoing.

11.2 The Company has appointed the Joint Sponsors to act as Joint Sponsors for the purposes of the Company's application for Admission.

12. Material Contracts

The following is a summary of each contract (not being a contract entered into in the ordinary course of business): (i) to which the Company or any member of the Group is or has been a party within the two years immediately preceding the date of this Prospectus which are, or may be, material; or (ii) that has been entered into by the Company or any member of the Group which contains any provision under which any member of the Group has any obligation or entitlement which is material to the Group as at the date of this Prospectus:

12.1 Underwriting Agreement

The Company entered into the Underwriting Agreement on 28 September 2012. Further details relating to that agreement is set out in "—*Underwriting Arrangements*" above.

12.2 Intermediaries Agreement

The Company, the Selling Shareholder, Barclays, the Joint Sponsors, the Joint Global Coordinators and the Intermediaries have entered into the Intermediaries Agreement. Pursuant to the terms of the Intermediaries Agreement:

(a) the Intermediaries agree that, in connection with the Intermediaries Offer, they will be acting as agent for their clients who apply for shares in the Intermediaries Offer (the "**Underlying Applicants**"). None of the Selling Shareholder, the Company, Barclays, the Joint Sponsors, the Joint Global Coordinators or the Managers will have any liability to the Intermediaries for liabilities, costs and expenses incurred by the Intermediaries in connection with the Intermediaries Offer;

(b) Barclays agrees to coordinate applications from the Intermediaries under the Intermediaries Offer. Determination of the Offer Price and the number of Intermediaries Offer Shares offered will be determined solely by the Selling Shareholder, the Company and the Joint Bookrunners. Allocations to Intermediaries will be determined solely by the Selling Shareholder, the Company, the Joint Bookrunners and Barclays. No specific number of shares has been set aside for allocation to the Intermediaries Offer and there will be no preferential treatment of Intermediaries;

(c) the Intermediaries agree to procure the investment of the maximum number of Ordinary Shares which can be acquired at the Offer Price for the sum applied for by such Intermediaries on behalf of their respective Underlying Applicants;

(d) a minimum application of £1,000 per Underlying Applicant will apply. Intermediaries agree not to make more than one application per Underlying Applicant;

(e) conditional upon Admission (as defined), the Selling Shareholder agrees to pay the Intermediaries a commission of, in aggregate, 1.00% of the aggregate value of the Ordinary Shares allocated to and paid for by each Intermediary in the Intermediaries Offer. This commission shall be deducted by Barclays from the gross proceeds of the Intermediaries Offer. No deductions may be made directly by Intermediaries from any amount they are required to pay under the Intermediaries Offer in respect of this commission;

(f) the Intermediaries give certain undertakings regarding their use of information provided in a fact sheet (prior to publication of this Prospectus) and other written information in connection with the Intermediaries Offer. The Intermediaries also give undertakings regarding the form and content of written and oral communications with clients; and

(g) the Intermediaries also give representations and warranties which are relevant for the Intermediaries Offer, and indemnify the Selling Shareholder, the Company and the Banks against any loss or claim arising out of any breach by them of the Intermediaries Agreement.

12.3 Relationship Agreement

The Company entered into the Relationship Agreement on 28 September 2012, conditional only on Admission, with the Selling Shareholder which will regulate (in part) the degree of control that the RBS Group and its associates may exercise over the management of the Company. The principal purpose of the Relationship Agreement is to ensure that the Company is capable at all times of carrying on its business independently of the RBS Group. The obligations of the RBS Group in connection with the fulfilment of this purpose is without prejudice to any action taken by it at any time after the date of the Agreement in connection with its obligations to divest its controlling interest in the Company by 31 December 2013, and divest any remaining interest by 31 December 2014.

The Relationship Agreement will take effect on Admission and will continue until the earlier of (i) the Ordinary Shares ceasing to be admitted to the Official List of the FSA and to trading on the London Stock Exchange or (ii) the RBS Group (or any member of its group) ceasing to be a significant shareholder of the company. For these purposes, a "significant shareholder" is any person (or persons acting jointly by agreement whether formal or otherwise) who is entitled to exercise, or to control the exercise of, 20% of the rights to vote at a general meeting of the Company or able to control the appointment of directors who are able to exercise a majority of votes at a meeting of the Board.

Under the Relationship Agreement, the RBS Group undertakes that it will comply with the requirements of any applicable laws, rules and regulations in relation to any dealings by it in the Ordinary Shares.

The Company undertakes that, for so long as the RBS Group is a significant shareholder of the Company, the Company shall not issue shares without the consent of the RBS Group, provided that consent will not be required, for example in relation to the issue of shares under any employee share scheme or share-based incentive plan; any issue of shares to any non-executive Director of the Company in accordance with their terms of appointment; allotments of shares in connection with any rights issue; on an annual basis, allotments of shares for cash or non-cash consideration representing in total up to 5% of the Company's issued share capital pursuant to any authority to allot shares granted to the Directors of the Company by the RBS Group; and any other equity capital raising required by applicable law or regulation.

The Relationship Agreement provides the RBS Group with the right to nominate (i) up to two persons to be members of the Board provided that the RBS Group holds 50% or more of the voting rights exercisable at a general meeting of the Company, and (ii) one person to be a member of the Board provided that the RBS Group holds 20% or more, but less than 50%, of the voting rights exercisable at a general meeting of the Company.

The Board believes that the terms of the Relationship Agreement will enable the Company to carry on its business independently from the RBS Group and its affiliates, and ensure that (subject to other existing contractual arrangements with the RBS Group as at the date of Admission) all transactions and relationships between the Company and the RBS Group and its affiliates are, and will be, at arm's length and on a normal commercial basis.

12.4 Tax Co-operation Agreement

The Tax Co-operation Agreement (the "**TCA**") entered into between the Company and the Selling Shareholder on 28 September 2012, governs the ongoing relationship between the Company and the Selling Shareholder between the date of Admission and the date on which the Selling Shareholder ceases to hold beneficially 50% or more of the ordinary share capital of the Company in relation to tax matters, including in relation to corporation tax, employee payroll taxes, VAT and insurance premium tax.

The TCA sets out certain overarching principles in relation to tax matters, including in particular, an acknowledgement from both parties that both the members of the RBS Group and the Group shall be responsible for discharging any tax for which they are liable. Under the TCA, the Selling Shareholder covenants to pay to the Company an amount equal to any unanticipated tax degrouping charges (subject to certain limited exceptions) that arise to any member of the Group as a result of it ceasing to be part of the RBS Group for tax purposes. The Selling Shareholder and the Company also provide reciprocal covenants under which they agree to pay each other an amount equal to any tax liability that arises under any secondary tax liability provisions to a company in the Group (in the case of the covenant from the Selling Shareholder) or to a company in the RBS Group (in the case of the covenant from the Company) as a result of a failure by the covenantor or one its subsidiaries to pay any tax for which it is primarily liable. The TCA also sets out the basis on which the RBS Group Tax department will provide support and assistance to the Company in relation to certain tax compliance matters, but confirms that the RBS Group Tax department shall not have any liability to the Group in respect of such support and assistance. Additionally, the TCA states that the Group will be required to comply with the Code of Practice on Taxation for Banks published by HMRC on 9 December 2009 until the Selling Shareholder ceases to hold 50% or more of the ordinary share capital or such other effective date that HMRC agree that the Group ceases to be controlled by the Selling Shareholder for the purpose of the Code of Practice. The Group undertakes to provide certain information to the RBS Group Tax department in respect of periods in which they remain part of the RBS Group for the relevant tax purposes.

12.5 Transitional Services Agreement ("TSA")

Under the TSA, entered into on 28 September 2012, The Royal Bank of Scotland Plc ("**RBS**") agrees to provide (or procure the provision of) IT and certain other services to DL Insurance Services Limited ("**DLISL**") for a transitional period and to support the migration of those services by DLISL to a replacement provider. The services comprise the provision of data centre, application and network infrastructure, end user desktops, energy procurement and hub and spoke mailroom services.

More specifically, the IT services comprise the following:

- Service Support and Delivery;
- Security Management;
- Disaster Recovery & Service Continuity;
- ESS Messaging;
- Hosting Services—Mid-Range;
- Hosting Services—Middleware;
- Hosting Services—Mainframe;

- Hosting Services—Wintel Server Services;
- Hosting Services—Database;
- Hosting Services—Storage;
- Hosting Services—Test Bed Management;
- Hosting Services—Web and Directory Services;
- Hosting Facilities—DC Facilities;
- End User Services;
- Technology Services—Change Demand;
- Local Area Network (LAN) Services;
- Network Services—Firewall;
- Network Services—Traffic Management;
- Fixed Telephony Services;
- Mobile Telephony Services;
- Voice and Call Centre;
- Wide Area Network (WAN) Services; and
- Technology Services—Application Support.

Non-IT services comprise the following:

- Business Continuity Services;
- Hub and Spoke Operations;
- Document Services;
- Corporation Tax Services;
- Third Party Assurance Services;
- Indirect Tax Services;
- Provision of FM Services at Peterborough; and
- Utility Procurement, Bill Validation, Energy Management and Environment Legislation Compliance.

Each service will be provided from the date of the IPO until a date specified in the TSA, being in the first instance, no later than 36 months after Admission. The Recipient has a right to extend the service term until completion of migration, subject to payment of additional charges.

Charges for the services are generally payable monthly, in arrears. The charges for the services will, subject to limited exceptions, be fixed until the end of 2013, unless a reduction is triggered as a result of agreed step-down provisions relating to reduced usage of the services. After that date, until the end of the initial term, the charges will be calculated either: (i) by reference to the initial fixed costs, as adjusted to take account of certain increases or decreases in demand for services compared to the initial fixed cost period; or (ii) in respect of certain other costs, by reference to the costs incurred by RBS on a pass-through basis. RBS is responsible for obtaining and maintaining third party consents as required for the first 24 months of the service term. DLISL is responsible for the costs of obtaining and maintaining third party consents after that date.

If DLISL continues to require services after the end of the scheduled end date, DLISL is required to provide advance notice to RBS and the charges for the provision of the services during that extended term or, if and to the extent the date of migration has been delayed due to further divestment activity undertaken by RBS, the revised target migration date will be subject to additional charges, which will increase by 10% each quarter depending on the duration of the overrun (subject to a cap on the increase of 40%).

DLISL may terminate any of the services before the scheduled end date, subject to providing six months' advance notice. Either party may terminate the TSA immediately if an insolvency related event occurs in relation to the other party, if the defaulting party does not remedy a material breach within 30 days of written notice or if a force majeure event has lasted for at least 30 days. However, even in these circumstances DLISL is entitled to continued provision of services, subject to payment of charges two months in advance. In certain circumstances, DLISL shall be required to pay all or a proportion of termination charges incurred by RBS (comprising decommissioning costs or costs payable to third-party suppliers).

RBS is required to provide the services in accordance with certain agreed quantitative and qualitative service levels (which are intended to be consistent with services levels to which those services are currently provided) and applicable law. A failure to meet certain service levels over consecutive periods will entitle DLISL to withhold (until resolution of the service level or termination or expiry of the agreement) an amount of the charges.

DLISL will be responsible for the coordination and planning of migration of the services to a replacement provider and will be supported by RBS. The responsibilities of the parties in relation to migration will be set out in a migration plan, an initial version of which will be attached to the TSA along with an agreed set of migration principles. The migration plan will be finalised by the parties after the commencement of services (and updated as required subject to the change control procedures). Each party is responsible for its own costs in relation to migration, in accordance with the scope and budgets set out in the agreed business case during the period of 36 months after Admission. After that date, DLISL will pay 50% of RBS's costs in excess of the budget set out in the agreed business case up to a cap of £10 million.

Changes to the nature and scope of the services provided under the TSA are subject to standard change control procedures, with different procedures applicable to mandatory changes (driven by changes to applicable law), compulsory changes (driven by changes in the RBS Group) and other discretionary changes requested by either party. Neither party can unreasonably withhold or delay its consent to any change requested by the other party.

Each party's liability shall be limited to 12 times the monthly charges in the month in which the claim arises less amounts paid in the previous 12 months (or in respect of any claim arising in the first month, £75 million less amounts already recovered in that month). In relation to deliberate breach of the agreement, each party's maximum liability is multiplied by three. The limits on liability do not apply to certain losses (e.g. for losses arising from fraud). In the event RBS is in breach as a result of a failure of an existing third party supplier and RBS has a right of recourse against that third party supplier, RBS will at its option either bring a claim and pass through a pro rata portion of any recovery to DLISL or take responsibility for that third party failure. If RBS does not have a right of recourse against that third party supplier, DLISL shall have no claim against RBS or the third party supplier. RBS agrees to certain obligations in relation to information security concerning the processing of DLISL data, including an obligation to keep that data confidential, to take steps to protect the integrity of DLISL data, to perform back-ups of certain DLISL data and to attempt to restore DLISL data in the event of a loss of data. RBS also agrees to have in place, maintain, test and (if required) implement disaster recovery plans.

RBS agrees to permit (or, to the extent it has the right to do so, to procure that its subcontractors and members of its group permit) audits of the provision of the services (including access to premises) by competent authorities, and to co-operate with those competent authorities. DLISL is also entitled to carry out a number of additional audits (including access to relevant information and personnel) to verify the provision of the services in accordance with the agreement during the term.

The services are subject to a multi-layered governance process. There is an agreed escalation process in the event of disputes between the parties.

12.6 Separation Agreement

The Separation Agreement (the "**Separation Agreement**") entered into between the Company and the Selling Shareholder on 28 September 2012 governs certain aspects of the relationship between the Group and the RBS Group following Admission. Under the Separation Agreement the parties will provide each other with certain warranties and customary indemnities on a reciprocal basis in respect of liabilities which the Company may incur but which relate to the RBS Group (other than the Group)

prior to the date of the agreement and vice versa. There are also provisions governing the Group's entitlement to use certain generic IP rights and know-how, the mutual non-solicitation of employees between the groups and release of any guarantees given. The Selling Shareholder has also given certain warranties to the Company regarding certain commercial arrangements that have been novated from the RBS Group to the Group as part of the preparation for separation.

12.7 The DLVA Acquisition Agreement

On 2 April 2012, the Company completed its purchase of the entire share capital of Direct Line Versicherung Aktiengessellschaft ("**DLVA**") from RBS Deutschland Holdings Gmbh (the "**Seller**"), pursuant to a sale and purchase agreement dated 16 March 2012 (the "**DLVA Acquisition Agreement**").

The total consideration payable for the shares at completion was €145.0 million. This amount was reduced by the transfer from the Seller to the Company of the free capital reserves of DLVA, in the amount of €20.0 million. In addition to the consideration, the Seller contracted to terminate a profit transfer agreement that had been entered into between the Seller and DLVA.

The Company entered into a tax covenant whereby it would inform the Seller about any action to be taken in relation to DLVA that could increase the Seller's tax liability for periods ending on or prior to 31 March 2012. The Company agreed to indemnify the Seller against retrospective measures pursuant to the German Reorganisation Tax Code, as long as they were initiated by the Company after 31 March 2012, related to periods ending on or prior to 31 March 2012, and in respect of which the Seller could be liable to pay taxes.

The Company warranted that it had the legal right and power to enter into and perform the DLVA Acquisition Agreement. The Seller made customary warranties about its legal existence, its authority to enter into the transaction and its legal and beneficial ownership of the shares.

12.8 Flexible Apportionment Agreement

On 29 June 2012, DLISL entered into an arrangement with RBS plc, National Westminster Bank plc and the trustee of the RBS Group Pension Fund to settle the debt owed to the trustee of the RBS Group Pension Fund by DLISL on its withdrawal from the scheme, and to obtain a discharge from any further liability under the rules of the RBS Group Pension Fund and the scheme funding and employer debt legislation. Under the terms of this arrangement (a flexible apportionment arrangement), DLISL paid £31.3 million to the trustee of the RBS Group Pension Fund which was the debt that had arisen in relation to the benefits that had accrued to DLISL's own current and former employees. All remaining liabilities of DLISL in relation to the scheme were assumed equally by RBS plc and National Westminster Bank plc as continuing employers in the RBS Group Pension Fund.

12.9 The Trust Deed

A trust deed (the "**Trust Deed**") dated 27 April 2012 constituting the £500,000,000 Fixed/Floating Rate Guaranteed Subordinated Notes due 2042 issued by the Company and guaranteed on a subordinated basis by U K Insurance Limited (the "**Notes**") was entered into between the Company as issuer, U K Insurance Limited as guarantor and BNY Mellon Corporate Trustee Services Limited as trustee. The Notes, which qualify as tier 2 capital of the Company, constitute direct, unsecured and subordinated obligations of the Company, and the guarantee in respect thereof constitutes the direct, unsecured and subordinated obligation of U K Insurance Limited.

12.10 The Subscription Agreement

A subscription agreement (the "**Subscription Agreement**") dated 25 April 2012 relating to the Notes was entered into among the Company as issuer, U K Insurance Limited as guarantor and Citigroup Global Markets Limited, HSBC Bank plc and The Royal Bank of Scotland plc as managers and underwriters of the Notes, pursuant to which the managers acquired the Notes from the issuer for approximately 99.200% of the principal amount thereof less certain fees and commissions, and the issuer and guarantor provided certain indemnities to the managers.

13. Taxation

13.1 UK taxation

The following statements are intended only as a general guide to certain UK tax considerations and do not purport to be a complete analysis of all potential UK tax consequences of acquiring, holding or disposing of Ordinary Shares. They are based on current UK tax law and what is understood to be the current practice (which may not be binding) of HM Revenue and Customs ("**HMRC**") as at the date of this Prospectus, both of which are subject to change, possibly with retrospective effect. They relate only to Shareholders who are resident (and, in the case of individuals, ordinarily resident and domiciled) for tax purposes in (and only in) the UK (except insofar as express reference is made to the treatment of non-UK residents), who hold their Ordinary Shares as an investment (other than under an individual savings account) and who are the absolute beneficial owner of both the Ordinary Shares and any dividends paid on them. The discussion does not address all possible tax consequences relating to an investment in the Ordinary Shares. The tax position of certain categories of Shareholders who are subject to special rules (such as persons acquiring (or deemed to acquire) their Ordinary Shares in connection with an office or employment, traders, brokers, dealers in securities, insurance companies, banks, financial institutions, investment companies, tax-exempt organisations, persons connected with the Company or the Group, persons holding Ordinary Shares as part of hedging or conversion transactions, Shareholders who are not domiciled or not ordinarily resident in the UK, collective investment schemes and those who hold 5% or more of the Ordinary Shares) is not considered nor is the tax position of any person holding investments in any HMRC-approved arrangements or schemes, including the enterprise investment scheme, venture capital scheme, or business expansion scheme, or able to claim any inheritance tax relief, or Shareholders that hold the Ordinary Shares in connection with a trade, profession or vocation carried on in the UK (whether through a branch or agency or, in the case of a corporate Shareholder, a permanent establishment or otherwise).

Prospective investors who are in any doubt as to their tax position or who may be subject to tax in a jurisdiction other than the UK are strongly recommended to consult their own professional advisers.

(a) Taxation of dividends

The Company will not be required to withhold UK tax at source from dividend payments it makes.

(i) Individuals

An individual Shareholder who is resident for tax purposes in the UK and who receives a cash dividend from the Company will generally be entitled to a tax credit equal to one-ninth of the amount of the cash dividend received, which is equivalent to 10% of the aggregate of the dividend received and the tax credit (the gross dividend), and will be subject to income tax on the gross dividend. An individual UK resident Shareholder who is subject to income tax at a rate or rates not exceeding the basic rate will be liable to tax on the gross dividend at the rate of 10%, so that the tax credit will satisfy the income tax liability of such a Shareholder in full. Where the tax credit exceeds the Shareholder's tax liability the Shareholder cannot claim repayment of the tax credit from HMRC. An individual UK resident Shareholder who is subject to income tax at the higher rate will be liable to income tax on the gross dividend at the rate of 32.5% to the extent that such sum, when treated as the top slice of that Shareholder's income, exceeds the threshold for higher rate income tax. After setting the 10% tax credit against part of the Shareholder's liability, a higher rate taxpayer will therefore be liable to account for tax equal to 22.5% of the gross dividend, (or 25% of the net cash dividend), to the extent that the gross dividend exceeds the threshold for the higher rate.

An individual UK resident Shareholder liable to income tax at the additional rate will be subject to income tax on the gross dividend at the rate of 42.5% of the gross dividend, but will be able to set the UK tax credit off against part of this liability. The effect of that set-off of the UK tax credit is that such a Shareholder will have to account for additional tax equal to 32.5% of the gross dividend (or approximately 36.1% of the net cash dividend) to the extent that the gross dividend exceeds the threshold for the additional rate (subject to the changes discussed below).

The UK Government has announced that the dividend additional rate will be reduced from 42.5% to 37.5%, with effect on and after 6 April 2013. From 6 April 2013 onwards a UK resident individual Shareholder liable to income tax at the additional rate will be subject to income tax on the gross

dividend at the rate of 37.5% but will be able to set the tax credit off against part of his liability. This will have the effect that the Shareholder will have to account for tax equal to 27.5% of the gross dividend (or approximately 30.6% of the net cash dividend), to the extent that the gross dividend exceeds the threshold for the additional rate.

(ii) Companies

Shareholders within the charge to UK corporation tax which are "small companies" for the purposes of Chapter 2 of Part 9A of the Corporation Tax Act 2009 will not be subject to UK corporation tax on any dividend received from the Company provided certain conditions are met (including an anti-avoidance condition).

Other Shareholders within the charge to UK corporation tax will not be subject to UK corporation tax on dividends received from the Company so long as the dividends fall within an exempt class and certain conditions are met. For example, dividends paid on shares that are "ordinary shares" and are not "redeemable" (as those terms are used in Chapter 3 of Part 9A of the Corporation Tax Act 2009), and dividends paid to a person holding less than 10% of the issued share capital of the Company should generally fall within an exempt class. However, the exemptions are not comprehensive and are subject to anti-avoidance rules.

If the conditions for exemption are not met or cease to be satisfied, or such a Shareholder elects for an otherwise exempt dividend to be taxable, the Shareholder will be subject to UK corporation tax on dividends received from the Company, at the rate of corporation tax applicable to that Shareholder (currently 24% for companies paying the full rate of corporation tax for accounting periods beginning on or after 1 April 2012, reducing by 1% per year until it reaches a rate of 22% for accounting periods beginning on or after 1 April 2014).

(iii) No Payment of Tax Credit

Individual UK resident Shareholders who are not liable to UK income tax in respect of the gross dividends, and other UK resident tax payers who are not liable to UK tax on dividends, including UK pension funds and charities, will not be entitled to claim repayment of the tax credit attaching to any dividends paid by the Company.

(iv) Non-UK Resident Shareholders

Shareholders who are resident outside the UK for tax purposes will not generally be able to claim repayment from HMRC of any part of the tax credit attaching to dividends received from the Company, although this will depend on the existence and terms of any double taxation convention between the UK and the country in which such Shareholder is resident. A Shareholder resident outside the UK may also be subject to taxation on dividend income under local law. A Shareholder who is not solely resident in the UK for tax purposes should consult his own tax advisers concerning his tax liabilities (in the UK and any other country) on dividends received from the Company, whether they are entitled to claim any part of the tax credit and, if so, the procedure for doing so, and whether any double taxation relief is due in any country in which they are subject to tax.

(b) Taxation of disposals

A disposal or deemed disposal of Ordinary Shares by a Shareholder who is (at any time in the relevant UK tax year) resident or, in the case of an individual, ordinarily resident in the UK for tax purposes may, depending upon the Shareholder's circumstances and subject to any available exemption or relief (such as the annual exempt amount for individuals and indexation allowance for corporate Shareholders), give rise to a chargeable gain or an allowable loss for the purposes of UK taxation of capital gains.

An individual Shareholder who has ceased to be resident or ordinarily resident for tax purposes in the UK for a period of less than five tax years and who disposes of all or part of his Ordinary Shares during that period may be liable to capital gains tax in respect of any chargeable gain arising from such a disposal on his return to the UK, subject to any available exemptions or reliefs.

(c) Stamp duty and Stamp Duty Reserve Tax ("SDRT")

The following statements are intended as a general guide to the current UK stamp duty and SDRT position and apply to holders of Ordinary Shares irrespective of their residence. Certain categories of person, including intermediaries, brokers, dealers and persons connected with depositary receipt systems and clearance services, may not be liable to stamp duty or SDRT or may be liable at a higher rate or may, although not primarily liable for tax, be required to notify and account for it under the Stamp Duty Reserve Tax Regulations 1986.

The Offer

The sale of Ordinary Shares by the Selling Shareholder under the Offer will generally give rise to a liability to stamp duty and/or SDRT at a rate of 0.5% of the Offer Price (in the case of stamp duty, rounded up to the nearest multiple of £5). Where Ordinary Shares are transferred into a clearance service or a depositary receipts system, as discussed below in the section entitled "Depositary Receipts Systems and Clearance Services" a liability to stamp duty or SDRT will generally be payable at the higher rate of 1.5% of the Offer Price. The Selling Shareholder has agreed to meet such liability, up to a maximum rate of 0.5%. An exemption from stamp duty is available on an instrument transferring Ordinary Shares where the amount or value of the consideration is £1,000 or less, and it is certificated on the instrument that the transaction effected by the instrument does not form part of a larger transaction or series of transactions in respect of which the aggregate amount or value of the consideration exceeds £1,000.

Subsequent transfers

Stamp duty at the rate of 0.5% (rounded up to the next multiple of £5) of the amount or value of the consideration given is generally payable on an instrument transferring Ordinary Shares. As noted above, an exemption from stamp duty is available on an instrument transferring Ordinary Shares where the amount or value of the consideration is £1,000 or less, and it is certified on the instrument that the transaction effected by the instrument does not form part of a larger transaction or series of transactions in respect of which the aggregate amount or value of the consideration exceeds £1,000.

A charge to SDRT will also generally arise on an unconditional agreement to transfer Ordinary Shares (at the rate of 0.5% of the amount or value of the consideration payable). However, if within six years of the date of the agreement (or, if the agreement is conditional, the date on which it becomes unconditional) an instrument of transfer is executed pursuant to the agreement, and stamp duty is paid on that instrument, any SDRT already paid will generally be refunded (generally, but not necessarily, with interest) provided that a claim for payment is made, and any outstanding liability to SDRT will be cancelled. The liability to pay stamp duty or SDRT is generally satisfied by the purchaser or transferee of the Ordinary Shares.

Ordinary Shares held through CREST

Paperless transfers of Ordinary Shares within CREST are generally liable to SDRT, rather than stamp duty, at the rate of 0.5% of the amount or value of the consideration payable. CREST is obliged to collect SDRT on relevant transactions settled within the CREST system. Under the CREST system, generally no stamp duty or SDRT will arise on a deposit of Ordinary Shares into the system unless such a transfer is made for a consideration in money or money's worth, in which case a liability to SDRT will arise usually at a rate of 0.5% of the amount or value of the consideration for the Ordinary Shares.

Depositary Receipt Systems and Clearance Services

Where Ordinary Shares are transferred (a) to, or to a nominee or an agent for, a person whose business is or includes the provision of clearance services or (b) to, or to a nominee or an agent for, a person whose business is or includes issuing depositary receipts, stamp duty or SDRT will generally be payable at the higher rate of 1.5% of the amount or value of the consideration given or, in certain circumstances, the value of the shares.

There is an exception from the 1.5% charge on the transfer to, or to a nominee or agent for, a clearance service where the clearance service has made and maintained an election under section 97A(1) of the Finance Act 1986, which has been approved by HMRC. In these circumstances, SDRT at the rate of 0.5% of the amount or value of the consideration payable for the transfer will arise on any transfer of Ordinary Shares into such an account and on subsequent agreements to transfer such shares within such account.

Any liability for stamp duty or SDRT in respect of a transfer into a clearance service or depositary receipt system, or in respect of a transfer within such a service, which does arise will strictly be accountable by the clearance service or depositary receipt system operator or their nominee, as the case may be, but will, in practice, be payable by the participants in the clearance service or depositary receipt system.

Inheritance tax

The Ordinary Shares will be assets situated in the UK for the purposes of UK inheritance tax. A gift of such assets by, or the death of, an individual holder of such assets may (subject to certain exemptions and reliefs) give rise to a liability to UK inheritance tax even if the holder is neither domiciled in the United Kingdom nor deemed to be domiciled there under certain rules relating to long residence or previous domicile.

For inheritance tax purposes, a transfer of assets at less than full market value may be treated as a gift and particular rules apply to gifts where the donor reserves or retains some benefit.

Special rules also apply to close companies and to trustees of settlements who hold Ordinary Shares, bringing them within the charge to inheritance tax. Shareholders should consult an appropriate professional adviser if they make a gift of any kind or transfer at less than market value or intend to hold any Ordinary Shares through such a company or trust arrangements. They should also seek professional advice in a situation where there is potential for a double charge to UK inheritance tax and an equivalent tax in another country or if they are in any doubt about their UK inheritance tax position.

13.2 US federal income taxation

TO ENSURE COMPLIANCE WITH INTERNAL REVENUE SERVICE ("IRS") CIRCULAR 230, EACH TAXPAYER IS HEREBY NOTIFIED THAT: (A) ANY TAX DISCUSSION HEREIN IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED BY THE TAXPAYER FOR THE PURPOSE OF AVOIDING US FEDERAL INCOME TAX PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER; (B) ANY SUCH TAX DISCUSSION WAS WRITTEN TO SUPPORT THE PROMOTION OR MARKETING OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) THE TAXPAYER SHOULD SEEK ADVICE BASED ON THE TAXPAYER'S PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

The following is a summary of certain US federal income tax considerations relevant to US Holders (as defined below) acquiring, holding and disposing of Ordinary Shares. This summary is based on the US Internal Revenue Code of 1986 (the "**Code**"), final, temporary and proposed US Treasury regulations, administrative and judicial interpretations, all of which are subject to change, possibly with retroactive effect, as well as on the income tax treaty between the United States and the United Kingdom as currently in force (the "**Treaty**").

This summary does not discuss all aspects of US federal income taxation that may be relevant to investors in light of their particular circumstances, such as investors subject to special tax rules (including, without limitation: (i) financial institutions; (ii) insurance companies; (iii) traders or dealers in stocks, securities, or currencies or notional principal contracts; (iv) regulated investment companies; (v) real estate investment trusts; (vi) tax-exempt organisations; (vii) entities that are treated as partnerships, or pass-through entities for US income tax purposes, or persons that hold Ordinary Shares through such entities; (viii) holders that are not US Holders; (ix) holders that own (directly, indirectly or constructively) 10% or more of the voting stock of the Company; (x) investors that hold Ordinary Shares as part of a straddle, hedge, conversion, constructive sale or other integrated transaction for US federal income tax purposes; (xi) investors that have a functional currency other than the US dollar and (xii) US expatriates and former long-term residents of the United States), all of whom may be subject to tax rules that differ significantly from those summarised below. This summary does not address tax consequences applicable to holders of equity interests in a holder of the Ordinary Shares, US federal estate, gift or alternative minimum tax considerations, or non-US, state or local tax considerations. This summary only addresses investors that will acquire Ordinary Shares in the Offer, and it assumes that investors will hold their Ordinary Shares as capital assets (generally, property held for investment).

For the purposes of this summary, a "**US Holder**" is a beneficial owner of Ordinary Shares that is for US federal income tax purposes (i) an individual who is a citizen or resident of the United States, (ii) a corporation created in, or organised under the laws of, the United States or any state thereof, including the District of Columbia, (iii) an estate the income of which is includible in gross income for US federal income tax purposes regardless of its source or (iv) a trust that is subject to US tax on its worldwide income regardless of its source.

(a) Distributions

Subject to the passive foreign investment company ("**PFIC**") rules discussed below, a distribution made by the Company on the Ordinary Shares (including amounts withheld in respect of foreign income tax, if any) generally will be treated as a dividend includible in the gross income of a US Holder as ordinary income. Such dividends will not be eligible for the dividends received deduction allowed to corporations. The Company does not expect to maintain calculations of earnings and profits for US federal income tax purposes. Therefore, a US Holder should expect that such distribution will generally be treated as a dividend.

"Qualified dividend income" received by individual and certain other non-corporate US Holders is currently subject to a maximum US federal income tax rate of 15% if (i) the Company is a "qualified foreign corporation" (as defined below) and (ii) such dividend is paid on Ordinary Shares that have been held by such US Holder for at least 61 days during the 121-day period beginning 60 days before the ex-dividend date. The Company generally will be a "qualified foreign corporation" if (1) it is either (a) eligible for the benefits of the Treaty, or (b) if the stock with respect to which such dividend is paid is readily tradable on an established securities market in the United States, and (2) it is not a PFIC in the taxable year of the distribution or the immediately preceding taxable year. The Company expects to be eligible for the benefits of the Treaty. In addition, as discussed below under "Passive Foreign Investment Company Rules", the Company does not believe it was a PFIC for the taxable year ending 31 December 2011 and does not expect to be a PFIC for the current year or for any future years.

Dividends on the Ordinary Shares generally will constitute income from sources outside the United States for foreign tax credit limitation purposes. The amount of any distribution of property other than cash will be the fair market value of the property on the date of the distribution.

The US dollar value of any distribution made by the Company in foreign currency must be calculated by reference to the exchange rate in effect on the date of receipt of such distribution by the US Holder, regardless of whether the foreign currency is in fact converted into US dollars. If the foreign currency so received is converted into US dollars on the date of receipt, such US Holder generally will not recognise foreign currency gain or loss on such conversion. If the foreign currency so received is not converted into US dollars on the date of receipt, such US Holder will have a basis in the foreign currency equal to its US dollar value on the date of receipt. Any gain or loss on a subsequent conversion or other disposition of the foreign currency generally will be treated as ordinary income or loss to such US Holder and generally will be income or loss from sources within the United States for foreign tax credit limitation purposes.

(b) Sale or other Disposition

Subject to the PFIC rules discussed below, a US Holder generally will recognise gain or loss for US federal income tax purposes upon a sale or other disposition of its Ordinary Shares in an amount equal to the difference between the amount realised from such sale or disposition and the US Holder's adjusted tax basis in such Ordinary Shares, as determined in US dollars. Such gain or loss generally will be capital gain or loss and will be long-term capital gain (taxable at a reduced rate for non-corporate US Holders, such as individuals) or loss if, on the date of sale or disposition, such Ordinary Shares were held by such US Holder for more than one year. The deducibility of capital loss is subject to significant limitations. Such gain or loss realised generally will be treated as derived from US sources.

A US Holder that receives foreign currency from a sale or disposition of Ordinary Shares generally will realise an amount equal to the US dollar value of the foreign currency on the date of sale or disposition or, if such US Holder is a cash basis or electing accrual basis taxpayer and the Ordinary Shares are treated as being traded on an "established securities market" for this purpose, the settlement date. If the Ordinary Shares are so treated and the foreign currency received is converted

into US dollars on the settlement date, a cash basis or electing accrual basis US Holder will not recognise foreign currency gain or loss on the conversion. If the foreign currency received is not converted into US dollars on the settlement date, the US Holder will have a basis in the foreign currency equal to the US dollar value on the settlement date. Any gain or loss on a subsequent conversion or other disposition of the foreign currency generally will be treated as ordinary income or loss to such US Holder and generally will be income or loss from sources within the United States for foreign tax credit limitation purposes.

(c) Passive Foreign Investment Company Rules

In general, a corporation organised or incorporated outside the United States is a PFIC in any taxable year in which, after taking into account the income and assets of certain subsidiaries, either (i) at least 75% of its gross income is classified as "passive income" or (ii) at least 50% of the average quarterly value attributable to its assets produce or are held for the production of passive income. Passive income for this purpose generally includes dividends, interest, royalties, rents and gains from commodities and securities transactions.

The PFIC rules provide that income derived in the active conduct of an insurance business by a corporation which is predominantly engaged in an insurance business is not treated as passive income. This exception is intended to ensure that income derived by a bona fide insurance company is not treated as passive income, except to the extent such income is attributable to financial reserves in excess of the reasonable needs of the insurance business.

Based on the present nature of its activities, including the planned Offer, and the present composition of its assets and sources of income, the Company believes that it was not a PFIC for the year ending on December 31, 2011 and does not expect to become a PFIC for the current year or for any future taxable year. There can be no assurances, however, that the Company will not be considered to be a PFIC for any particular year because PFIC status is factual in nature, generally cannot be determined until the close of the taxable year in question, and is determined annually. If the Company is classified as a PFIC in any year that a US Holder is a shareholder, the Company generally will continue to be treated as a PFIC for that US Holder in all succeeding years, regardless of whether the Company continues to meet the income or asset test described above. If the Company were a PFIC in any taxable year, materially adverse US federal income tax consequences could result for US Holders.

If a US Holder does not make a valid election as discussed below, and the Company is a PFIC for any taxable year during which an investor is a US Holder, the investor will be subject to special tax rules with respect to any "excess distribution" received and any gain realised from a sale or other disposition (including a pledge) of Ordinary Shares. Distributions received in a taxable year that are greater than 125% of the average annual distributions received during the shorter of the three preceding taxable years or the US Holder's holding period for the Ordinary Shares will be treated as excess distributions. Under these special tax rules, (i) the excess distribution or gain will be allocated ratably over the US Holder's holding period for the Ordinary Shares; (ii) the amount allocated to the current taxable year and other years before the Company was a PFIC will be treated as ordinary income; and (iii) the amount allocated to each other year will be subject to tax at the highest tax rate in effect for that year and an interest charge (at the rate generally applicable to underpayments of tax for the period from such year to the current year) will be imposed on the resulting tax attributable to each such year. A US Holder will generally be subject to similar rules with respect to distributions to the Company by, and dispositions by the Company of the stock of, any direct or indirect subsidiaries of the Company that are also PFICs.

A US Holder subject to the PFIC rules discussed above or below is currently required to file IRS Form 8621 with respect to its investment in the Ordinary Shares in the year such US Holder receives any distribution upon, or makes any disposition of, such shares. It is expected that such filing will be required annually upon finalisation of implementing guidance.

Mark-to-market election

To mitigate the adverse consequences of the PFIC rules discussed above, a US Holder may make an election to include gain or loss on the Ordinary Shares as ordinary income or loss under a mark-to-market method, provided that the Ordinary Shares are regularly traded on a qualified exchange. Application has been made for the Ordinary Shares to be admitted to the London Stock Exchange's main market for listed securities, which the Company expects to be a qualified exchange.

No assurance can be given that the Ordinary Shares will be "regularly traded" for purposes of the mark-to-market election. If a US Holder makes an effective mark-to-market election, the US Holder will include in each year as ordinary income the excess of the fair market value of its Ordinary Shares at the end of the year over its adjusted tax basis in the Ordinary Shares. The US Holder will be entitled to deduct as an ordinary loss each year the excess of its adjusted tax basis in the Ordinary Shares over their fair market value at the end of the year, but only to the extent of the net amount previously included in income as a result of the mark-to-market election. A US Holder's adjusted tax basis in the Ordinary Shares will be increased by the amount of any income inclusion and decreased by the amount of any deductions under the mark-to-market rules. In addition, gains from an actual sale or other disposition of Ordinary Shares will be treated as ordinary income, and any losses will be treated as ordinary losses to the extent of any mark-to-market gains for prior years.

If a US Holder makes a mark-to-market election, it will be effective for the taxable year for which the election is made and all subsequent taxable years unless the Ordinary Shares are no longer regularly traded on a qualified exchange or the IRS consents to the revocation of the election.

Qualified electing fund election

To mitigate the adverse consequences of the PFIC rules discussed above, a US Holder may make an election to treat the Company as a qualified electing fund ("**QEF**") for US federal income tax purposes. To make a QEF election, the Company must provide US Holders with information compiled according to US federal income tax principles. The Company currently does not intend to compile such information for US Holders, and therefore it is expected that this election will be unavailable.

(d) US information Reporting, Backup Withholding Tax, and FATCA

Payments made through a US paying agent or US intermediary to a US Holder may be subject to information reporting unless the US Holder establishes that payments to it are exempt from these rules. Payments that are subject to information reporting may be subject to backup withholding if a US Holder does not provide its taxpayer identification number and otherwise comply with the backup withholding rules. Backup withholding is not an additional tax. Amounts withheld under the backup withholding rules are available to be credited against a US Holder's US federal income tax liability and may be refunded to the extent they exceed such liability, provided the required information is timely provided to the IRS.

Under US federal income tax law and regulations, certain categories of US persons must file information returns with respect to their investment in the equity interests of a foreign corporation. A US person that purchases for cash Ordinary Shares will be required to file IRS Form 926 or similar form if the transfer, when aggregated with all transfers made by such person (or any related person) within the preceding 12 month period, exceeds US$100,000. In the event a US Holder fails to file any such required form, the US Holder could be required to pay a penalty equal to 10% of the gross amount paid for such Ordinary Shares up to a maximum penalty of US$100,000.

Individual US Holders may be required to report to the IRS certain information with respect to their beneficial ownership of the Ordinary Shares not held through an account with a financial institution. Investors who fail to report required information could be subject to substantial penalties.

The Company and financial institutions through which payments of dividends on, and the proceeds from the dispostion of, ordinary shares are made may be required to withhold US tax at a rate of 30% on all, or a portion of payments pursuant to Sections 1471 through 1474 of the Code or similar law implementing an intergovernmental approach thereto ("**FATCA**"). See *Risk Factors—Risks Relating to the Group—US Foreign Account Tax Compliance Withholding* for additional information. In certain circumstances, the withholding may be refundable or creditable. FATCA is particularly complex and its application is uncertain at this time. Prospective investors should consult their own tax advisers on how these rules may apply to the Company and to payments investors may receive.

US Holders should note that the discussion above entitled "*—UK Taxation*" in this Part XVI: Additional Information is also relevant. See in particular the discussion entitled "*—Stamp duty and Stamp Duty Reserve Tax* ("*SDRT*")".

14. Litigation and Arbitration

Save for the possible impact of *Simmons v. Castle* to which the Group is not a party (see "Part II: "*Risk Factors—Changes in laws, regulations, government policies and their enforcement and interpretations could adversely affect the Group*"), there are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Company is aware) covering at least the 12 months preceding the date of this Prospectus which may have, or have had a significant effect on the Company's and/or Group's financial position or profitability.

15. Related Party Transactions

15.1 Save:

(i) as described in the Group's historical financial information for the three years ended 31 December, 2011, 2010, 2009 and the six months ended 30 June 2012 set out in the note 39 to Part XIII: "*Financial Information*";

(ii) for the Relationship Agreement (see "*Material Contracts—12.3*"), the Tax Co-operation Agreement (see "*Material Contracts—12.4*"), the Transitional Services Agreement (see "*Material Contracts—12.5*") and the Separation Agreement (see "*Material Contracts—12.6*"), each of which has been entered into but will only become effective on Admission; and

(iii) as set out below in paragraphs 15.2, 15.3 and 15.4,

there were no related party transactions entered into by the Company or any member of the Group during the financial years ended 31 December, 2011, 2010, 2009 and the six months ended 30 June 2012 and 2011 and during the period up to 28 September 2012.

15.2 RBS plc, National Westminster Bank Plc, The Royal Bank of Scotland International Limited, Coutts & Company and certain other RBS Group banks (the "**RDA Banks**") have entered into a retail distribution agreement dated 21 September 2012 (the "**RDA**") with U K Insurance and Direct Line Life Insurance Company Limited (the "**Insurers**"). The Selling Shareholder will also be a party to the RDA for the purpose of granting trade mark licences to the Insurers. The RDA is an arm's-length contract and replaces the existing arrangements relating to the distribution by the RDA Banks of the Insurers' insurance products.

Under the RDA, the RDA Banks agree to distribute certain specified insurance products of the Insurer (both policies which are sold on a stand-alone basis and policies which are provided with packaged bank accounts and cards). The main insurance products that are covered are home and motor (stand-alone insurance) and travel and rescue (packaged insurance), along with various other retail bank focused insurance products. The RDA Banks grant the Insurers exclusivity in respect of the arrangements that are in place as at the commencement of the RDA. In relation to stand-alone insurance products, the Insurers are also granted rights of first refusal if a RDA Bank wants to sell a current product under a new distribution channel or a new product within certain restricted categories of insurance (home, motor, travel, rescue and income protection insurance). The financial arrangements under the RDA took effect from 1 January 2012 and the other provisions take effect from the date of Admission. The RDA has a term of five years from Admission.

Each party's liability to all other parties under the agreement is limited to £30 million in the annual aggregate. The limits on liability do not apply to certain losses including losses arising from third-party claims arising from a breach of the RDA in respect of which liability is unlimited and to any losses arising from a breach of permitted use of the customer data, confidentiality, information security, data protection and other regulatory obligations in respect of which liability is limited to £200 million.

15.3 RBS Plc and National Westminster Bank Plc (the "**CDA Banks**") have entered into a commercial insurance distribution agreement dated 21 September 2012 (the "**CDA**") with UK Insurance Business Solutions Limited ("**UKBIS**"). The Selling Shareholder will also be a party to the CDA for the purpose of granting a trade mark licence to UKBIS. The CDA replaces the existing contracts relating to the referral of business customers by the CDA Banks to UKBIS and puts the relationship on an arm's-length basis.

Under the CDA, the CDA Banks agree to refer customers of their Business Banking Division, Corporate and Institutional Banking Division and Commercial Banking Division either to UKBIS or to a broker panel established by UKBIS under the CDA for the purpose. The purpose of the referral

is for UKBIS or the broker panel then to provide commercial insurance services including arranging all types of commercial and other business insurance. The CDA Banks grant UKBIS exclusivity in respect of the provision of these commercial insurance services.

Most obligations under the CDA take effect from the date of execution, the financial arrangements under the CDA take effect on 1 January 2013 and the obligations in relation to the broker panel take effect from 31 March 2013 and certain minor provisions take effect from 1 September 2013. The CDA has a term of five years from Admission.

Each party's liability to all other parties under the agreement is limited to £5 million in the annual aggregate.

15.4 The following transactions were carried out with related parties, who are all members of the RBS Group.

(i) Sales of insurance contracts and other services

	Two months ended 31 August 2012
	£ million
Parent	—
Fellow subsidiaries	0.9
Total	0.9

(ii) Purchases of services

	Two months ended 31 August 2012
	£ million
Parent	27.5
Fellow subsidiaries	11.7
Total	39.2

Purchases of services are charged on an arm's length basis Employee. Employee costs recharged by RBS Group and include the full costs of key managers and other staff in respect of share-based payments. The attribution among members of the RBS Group has regard to the needs of the RBS Group as a whole.

(iii) Compensation of key management

The aggregate remuneration of directors and other members of key management during the year was as follows:

	Two months ended 31 August 2012
	£ million
Fees as directors	—
Other emoluments	1.5
Company pension contributions	0.1
Compensation for loss of office	—
Total	1.6

(iv) An amount of £3.8 million was also invoiced and paid to The Royal Bank of Scotland plc for the acquisition of furniture, fittings and IT hardware in September 2012.

16. Working Capital

In the opinion of the Company, the working capital available to the Group is sufficient for the Group's present requirements, that is, for at least the 12 months following the date of this Prospectus.

17. No Significant Change

Save for the dividend of £200 million declared and paid by the Company to the RBS Group on 3 September 2012, there has been no significant change in the financial or trading position of the Group since 30 June 2012, the date to which the last audited combined financial information of the Group in Part XIII: "*Financial Information*" was prepared.

18. Mandatory bids and compulsory acquisition

18.1 The City Code applies to the Company. For a discussion of how the City Code will apply to the Company after Admission, see Part VIII: "*Directors, Senior Management and Corporate Governance—Takeover Regulation*".

18.2 Under Sections 974 to 991 of the Companies Act, if an offeror acquires or contracts to acquire (pursuant to a takeover offer) not less than 90% of the shares in the Company (in value and by voting rights) to which such offer relates, it may then compulsorily acquire the outstanding shares not assented to the offer. The offeror would do so by sending a notice to outstanding holders of shares telling them that it will compulsorily acquire their shares and then, six weeks later, it would execute a transfer of the outstanding shares in its favour and pay the consideration to the Company, which would hold the consideration on trust for the outstanding holders of shares. The consideration offered to the holders whose shares are compulsorily acquired under the Companies Act must, in general, be the same as the consideration that was available under the takeover offer.

In addition, pursuant to Section 983 of the Companies Act, if an offeror acquires or agrees to acquire not less than 90% of the shares in the Company (in value and by voting rights) to which the offer relates, any holder of shares to which the offer relates who has not accepted the offer may require the offeror to acquire his/her shares on the same terms as the takeover offer. The offeror would be required to give any holder of shares notice of his/her right to be bought out within one month of that right arising. These sell-out rights cannot be exercised after the end of the period of three months from the last date on which the offer can be accepted or, if later, three months from the date on which the notice is served on the holder of shares notifying him/her of their sell-out rights. If a holder of shares exercises his/her rights, the offeror is bound to acquire those shares on the terms of the offer or on such other terms as may be agreed.

19. Auditors

19.1 Deloitte LLP, whose address is 2 New Street Square, London EC4A 3BZ, United Kingdom, have been the auditors of the Company since 31 December 2000.

19.2 Deloitte LLP is a member of the Institute of Chartered Accountants in England and Wales and has no material interest in the Company.

19.3 Deloitte LLP has given and has not withdrawn its written consent to the inclusion in this Prospectus of its accountants reports in Part XIV: "*Unaudited Pro Forma Financial Information*" and Part XIII: "*Financial Information*" of this Prospectus, and references thereto in the form and context in which they appear and has authorised the contents of those parts of this Prospectus which comprise its reports for the purposes of PR 5.5.3R(2)(f) of the Prospectus Rules. As the Ordinary Shares have not been and will not be registered under the Securities Act Deloitte LLP has not filed and will not be required to file a consent under the Securities Act.

20. Actuarial Expert

20.1 The Actuarial Expert, whose address is Saddlers Court, 64-74 East Street, Epsom, Surrey KT17 1HB, United Kingdom has no material interest in the Company.

20.2 The Actuarial Expert has given and has not withdrawn its written consent to the inclusion in this Prospectus of its name, its report in Part XV: "*Actuarial Report*" and references to its name and that report in the form and context in which they appear and have authorised the contents of those parts of this Prospectus which comprise its report for the purposes of PR 5.5.3R(2)(f) of the Prospectus Rules.

21. General

21.1 The total costs and expenses of, and incidental to the Admission and the Offer (including the listing fees, printer's fees, advisers' fees, professional fees and expenses and the costs of printing and

distribution of documents) are estimated to amount to £33.6 million (excluding VAT and stamp duty) and are payable by the Company and the Selling Shareholder. Included within the total are commissions which are expected to be up to approximately £13.6 million payable to the Institutional Offer Underwriters (assuming that the number of Offer Shares sold is the mid-point between 25.0% and 33.3% of the total number of issued Ordinary Shares and that there is no exercise of the Over-allotment Option, and excluding any discretionary commissions).

21.2 The financial information contained in this Prospectus which relates to the Company does not constitute full statutory accounts as referred to in section 434(3) of the Companies Act. Statutory audited accounts of the Company, on which the auditors have given its unqualified report and which contained no statement under section 498(2) or (3), have been delivered to the Registrar of Companies in respect of the three accounting periods ended 31 December 2011.

21.3 The Intermediaries authorised at the date of this Prospectus to use this Prospectus in connection with the Intermediaries Offer are:

Name	Address
AJ Bell Securities Limited	Trafford House, Chester Road, Manchester M32 0RS
Barclays Stockbrokers Ltd.	Tay House, 300 Bath Street, Glasgow G2 4JR
Blankstone Sington Ltd.	Walker House, Exchange Flags, Liverpool L2 3YL
Canaccord Genuity Limited (Collins Stewart Wealth Management Ltd)	9th Floor, 88 Wood Street, London EC2V 7QR
Charles Stanley & Co. Limited	25 Luke Street, London EC2A 4AR
Fitel Nominees Limited (WH Ireland)	11 St James's Square, Manchester M2 6WH
Hargreave Hale Ltd.	Neptune Court, Hallam Way, Blackpool, Lancs FY4 5LZ
Hargreaves Lansdown Asset Management	1 College Square South, Anchor Road, Bristol BS1 5HL
Interactive Investor Trading Limited	Standon House, 21 Mansell Street, London E1 8AA
Jarvis Investment Management Ltd	78 Mount Ephraim, Tunbridge Wells, Kent TN4 8BS
Killik & Co. LLP	46 Grosvenor Street, London W1K 3HN
NatWest Stockbrokers Limited	Premier Place, 2½ Devonshire Square, London EC2M 4BA
Paul E. Schweder Miller & Co.	46-50 Tabernacle Street, London EC2A 4SJ
Redmayne-Bentley LLP	9 Bond Court, Leeds LS1 2JZ
Simplystockbroking Limited	49, Whitehall, London SW1A 2BX
Talos Securities Ltd (trading as Selftrade)	Boatman's House, 2 Selsdon Way, London E14 9LA
TD Direct Investing (Europe) Limited	Exchange Court, Duncombe Street, Leeds LS1 4AX
The Share Centre Limited	Oxford House, Oxford Road, Aylesbury, Buckinghamshire HP21 8SZ
Walker Crips Stockbrokers Limited	Finsbury Tower, 103-105 Bunhill Row, London EC1Y 8LZ

21.4 Solid Solutions Associates of 5 St. John's Lane, London EC1M 4BH are assisting Barclays with the coordination of the Intermediaries Offer.

21.5 Any new information with respect to financial intermediaries unknown at the time of approval of this Prospectus including whether an Intermediary ceases to participate in the Intermediaries Offer will be available on the Company's website at www.directlinegroup.com.

22. Documents Available for Inspection

Copies of the following documents are available for inspection during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) for a period of 12 months from the date of Admission at the offices of Allen & Overy LLP, One Bishops Square, London E1 6AD, United Kingdom and at the Company's registered office at Churchill Court, Westmoreland Road, Bromley BR1 1DP, United Kingdom:

(a) the existing memorandum and articles of association of the Company and the articles of association adopted by the Company;

(b) the consent letters referred to in "*—Auditors*" and "*—Actuarial Expert*" in this Part XVI;

(c) the report from Deloitte LLP set out in Part XIII: "*Financial Information*" of this Prospectus;

(d) the Actuarial Report;

(e) this Prospectus.

Dated 28 September 2012

PART XVII—DEFINITIONS

The following definitions apply throughout this Prospectus unless the context requires otherwise:

2010 PD Amending Directive	Directive 2010/73/EU
Actuarial Expert	Towers Watson Limited
Actuarial Report	the report set out in Part XV of this Prospectus by the Actuarial Expert
Admission	admission of the Ordinary Shares to the Official List and to trading on the main market for listed securities of the London Stock Exchange becoming effective in accordance with LR 3.2.7G of the Listing Rules and paragraph 2.1 of the Admission and Disclosure Standards published by the London Stock Exchange
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht
Banking Act	Banking Act 2009
Banks	the Joint Sponsors, the Joint Bookrunners, the Managers and Barclays
Barclays	Barclays Bank PLC
Churchill	Churchill Insurance Company Limited
City Code	the City Code on Takeovers and Mergers
Co-Managers	BNP Paribas, Commerzbank Aktiengesellschaft, Investec Bank plc, Keefe, Bruyette & Woods Limited and RBC Europe Limited
Companies Act	Companies Act 2006, as amended
Company	Direct Line Insurance Group plc
CREST	the electronic transfer and settlement system for the paperless settlement of trades in listed securities operated by CRESTCo
CRESTCo	Euroclear UK and Ireland Limited, the operator (as defined in the CREST Regulations) of CREST
CREST Regulations	the Uncertificated Securities Regulations 2001 (SI 2001/3755), as amended
Defra	Department for Environment, Food and Rural Affairs
Directors or **Board**	the Executive and Non-Executive Directors of the Company
Disclosure and Transparency Rules	the disclosure and transparency rules made by the FSA under Part VI of the FSMA
DL4B	Direct Line for Business
DLISL	DL Insurance Services Limited
European Economic Area or EEA	the European Union, Iceland, Norway and Liechtenstein
Exchange Act	the US Securities Exchange Act of 1934, as amended
Executive Directors	Paul Robert Geddes and Anthony Jonathan Reizenstein
Fitch	Fitch, Inc., Fitch Ratings Ltd or, where the context requires, another ratings provider within the Fitch group
FSA	the UK Financial Services Authority
FSMA	the UK Financial Services and Markets Act 2000, as amended

Goldman Sachs	Goldman Sachs International, an unlimited company incorporated in England and Wales with registered number 2263951
Green Flag	Green Flag Holdings Limited
Group	the Company and its subsidiaries and subsidiary undertakings, and, where the context requires it, its associated undertakings
IFRS	International Financial Reporting Standards, as adopted by the European Commission for use in the European Union
Institutional Banks	the Joint Sponsors, the Joint Global Coordinators, the Joint Bookrunners and the Managers
Institutional Offer	the offer of Ordinary Shares to certain institutional investors including QIBs in the United States described in Part VI: "*Details of the Offer*"
Institutional Offer Shares	the Offer Shares sold pursuant to the Institutional Offer
Institutional Offer Underwriters	the Joint Bookrunners and the Managers
Intermediaries	AJ Bell Securities Limited, Barclays (in its capacity as an Intermediary), Blankstone Sington Ltd., Canaccord Genuity Limited (Collins Stewart Wealth Management Ltd), Charles Stanley & Co. Limited, Fitel Nominees Limited (WH Ireland), Hargreave Hale Ltd., Hargreaves Lansdown Asset Management, Interactive Investor Trading Limited, Jarvis Investment Management Ltd., Killik & Co. LLP, NatWest Stockbrokers Limited, Paul E. Schweder Miller & Co., Redmayne-Bentley LLP, Talos Securities Ltd (trading as Selftrade), TD Direct Investing (Europe) Limited, The Share Centre Limited and Walker Crips Stockbrokers Limited together with any intermediary financial institution (if any) that agrees to adhere to and be bound by the terms of the Intermediaries Agreement following the date of this document)
Intermediaries Agreement	the agreement in respect of the Intermediaries Offer between the Company, the Selling Shareholder, Barclays, the Joint Sponsors, the Managers and the Intermediaries
Intermediaries Offer	the offer to the Intermediaries described in Part VI: "*Details of the Offer*"
Intermediaries Offer Shares	the Offer Shares sold pursuant to the Intermediaries Offer
Intermediaries Offer Underwriter	Barclays
ISVAP	Instituto per la Vigilanza sulle Assicurazioni Private di Interesse Collettivo
Joint Bookrunners	Goldman Sachs, Morgan Stanley Securities and UBS Limited
Joint Global Coordinators	Goldman Sachs and Morgan Stanley Securities
Joint Lead Managers	Citigroup Global Markets Limited, HSBC Bank plc, Merrill Lynch International
Joint Sponsors	Goldman Sachs and Morgan Stanley
Listing Rules	the listing rules of the FSA relating to admission to the Official List
London Stock Exchange	London Stock Exchange plc
Managers	Joint Lead Managers and the Co-Managers
Member State	member state of the EU

Moody's	Moody's Investors Service Limited or, where the context requires, another ratings provider within the Moody's group.
Morgan Stanley	Morgan Stanley & Co. International plc, a public limited company incorporated in England and Wales with registered number 02068222
Morgan Stanley Securities	Morgan Stanley Securities Limited
NIG	The National Insurance and Guarantee Corporation Limited
Non-Executive Directors	Michael Nicholas Biggs, Andrew William Palmer, Jane Carolyn Hanson, Clare Eleanor Thompson, Priscilla Audrey Vacassin, Bruce Winfield Van Saun, Mark Catton and Glyn Parry Jones
Offer	the sale of the Offer Shares by the Selling Shareholder pursuant to the Institutional Offer and the Intermediaries Offer described in Part VI: "*Details of the Offer*"
Offer Price	the offer price per Ordinary Share to be confirmed in the Pricing Statement
Offer Shares	those Ordinary Shares to be sold under the Offer by the Selling Shareholder
Official List	the Official List maintained by the FSA
OFT	the Office of Fair Trading
Order	Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended)
Ordinary Shares	ordinary shares of 10p each in the Company
Over-allotment Option	the over-allotment option granted by the Company to the Stabilising Manager in the Underwriting Agreement
Over-allotment Shares	Ordinary Shares to be offered pursuant to the Over-allotment Option
PDMR	person discharging managerial responsibilities within the meaning of section 96B(1) of the FSMA
Price Range	160p to 195p
Price Range Prospectus or Prospectus	this document
Pricing Statement	the statement to be published by the Company and the Ordinary Shares prepared in accordance with the Listing Rules and the Prospectus Rules
Privilege	Privilege Insurance Company Limited
Prospectus Directive	Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive to the extent implemented in the Relevant Member State) and includes any relevant implementing measure in each Relevant Member State
Prospectus Rules	the prospectus rules of the FSA made under Part VI of the FSMA relating to offers of securities to the public and admission of securities to trading on a regulated market
Qualified Institutional Buyer or **QIB**	Qualified Institutional Buyer within the meaning given by Rule 144A under the Securities Act
RBS	The Royal Bank of Scotland Group plc
RBS Group	RBS and its subsidiaries and subsidiary undertakings, and, where the context requires it, its associated undertakings

RBS Group Employee Share Plans	the RBS 2010 Long Term Incentive Plan, the RBS 2010 Deferral Plan, the RBS Group Medium-Term Performance Plan, the RBS Group Restricted Share Plan and The Royal Bank of Scotland Group plc 2007 Sharesave Plan
Regulation S	Regulation S under the Securities Act
Relationship Agreement	the relationship agreement between the Company and the Selling Shareholder
Relevant Member State	each Member State of the European Economic Area that has implemented the Prospectus Directive
Road Traffic Act	Road Traffic Act 1988
Rule 144A	Rule 144A under the Securities Act
S&P	Standard & Poor's Credit Market Services Europe Limited or, where the context requires, another ratings provider within the Standard & Poor's group.
SEC	the US Securities and Exchange Commission
Securities Act	the US Securities Act of 1933, as amended
Selling Shareholder	The Royal Bank of Scotland Group plc
Senior Managers	the persons named as Senior Managers in Part VIII: "*Directors, Senior Management and Corporate Governance*"
Shareholders	holders of Ordinary Shares
Solvency II	the new regime in relation to solvency requirements and other matters, affecting the financial strength of insurers and reinsurers
Stabilising Manager	Goldman Sachs
Takeover Panel	the Panel on Takeovers and Mergers
TCA	Tax Co-operation Agreement
TPF	Tesco Personal Finance Limited
UCITS	undertakings for collective investment in transferable securities
UK BIS	UK Insurance Business Solutions Limited
UK Corporate Governance Code	the UK Corporate Governance Code dated June 2010 issued by the Financial Reporting Council
UK GAAP	generally accepted accounting principles in the United Kingdom
U K Insurance	U K Insurance Limited, the Group's principal UK statutory general underwriting entity
Underwriters	the Institutional Offer Underwriters and the Intermediaries Offer Underwriter
Underwriting Agreement	the underwriting agreement entered into between the Company, the Directors, the Selling Shareholder and the Banks on 28 September 2012 and described in Part XVI: "*Additional Information*"
United Kingdom or **UK**	the United Kingdom of Great Britain and Northern Ireland
United States or **US**	the United States of America, its territories and possessions, any state of the United States of America and the District of Columbia
US GAAP	generally accepted accounting principles in the US

PART XVIII—GLOSSARY

The following technical terms (or variations thereof) are used in this Prospectus:

CAGR	compound annual growth rate
car parc	total number of cars in a country
GWP	gross written premium
IGD	Insurance Groups Directive
Ogden discount rate	the discount rate to be selected from the Ogden tables which are prepared by the Government Actuary's Department in the UK. The discount rate represents the assumed long-term real rate of return in the calculation of lump sum compensation payments in personal injury and fatal accident insurance claims. The discount rate to be used in the calculation is determined by the Lord Chancellor
PCW	price comparison website
PL	personal lines
Pool Re.	a scheme set up by the insurance industry in co-operation with the UK government so that insurers can continue to cover losses resulting from damage caused by acts of terrorism to commercial property in Great Britain
PPI	payment protection insurance
PPO	periodical payment order
	The Courts Act 2003, implemented in 2005, introduced the ability to award periodical payment orders instead of lump sums in large bodily injury cases. Periodical payment orders replace a lump sum with an index linked amount payable to a claimant annually either for a period of time or for the rest of his/her life
SME	small and medium-sized enterprises

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Merrill Corporation Ltd, London
12ZCO74101

Registered Office:
Direct Line Insurance Group
Churchill Court
Westmoreland Road
Bromley BR1 1DP